

FEDERAL RESERVE SYSTEM**12 CFR Part 229****[Regulation CC; Docket No. R-1176]****Availability of Funds and Collection of Checks****AGENCY:** Board of Governors of the Federal Reserve System.**ACTION:** Final rule.

SUMMARY: The Board of Governors is publishing final amendments to Regulation CC that add a new subpart D, with commentary, to implement the Check Clearing for the 21st Century Act. These amendments set forth the requirements of the Act that apply to banks, a model consumer awareness disclosure and other model notices, and indorsement and identification requirements for substitute checks. The final amendments also clarify some existing provisions of the rule and commentary.

DATES: This rule is effective on October 28, 2004, except for model form C-5A in appendix C, which is effective August 4, 2004, and paragraph (4) of appendix D, which is effective on January 1, 2006.

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 Stephanie Martin, Associate General Counsel ((202) 452-3198), 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***I. The Need for and General Provisions of the Check 21 Act*

Under current law, a bank must present the original paper check for payment unless the paying bank has agreed to accept presentment in some other form.¹ Sections 3-501(b)(2) and 4-110 of the Uniform Commercial Code (U.C.C.) specifically authorize banks and other persons to agree to alternative means of presentment, such as electronic presentment. However, to engage in broad-based electronic presentment, a presenting bank would need electronic presentment agreements with each bank to which it presents checks. This has proven impracticable because of both the large number of

paying banks and the unwillingness of some paying banks to receive electronic presentment.² The requirement that banks present the original check absent agreement to the contrary and the difficulty of obtaining alternate presentment agreements with all paying banks impedes the ability of banks that want to process checks electronically to take full advantage of that technology. As a result, the payment system as a whole has not achieved the efficiencies and potential cost savings associated with handling checks electronically.

By authorizing the use of a new negotiable instrument called a substitute check, the Check Clearing for the 21st Century Act (the Check 21 Act or the Act) facilitates the broader use of electronic check processing without mandating that any bank change its current check collection practices.³ A substitute check is a paper reproduction of an original check that contains an image of the front and back of the original check, is suitable for automated processing in the same manner as the original check, and meets other technical requirements. A bank that for consideration transfers, presents, or returns a substitute check (or a paper or electronic representation of a substitute check) warrants that (1) the substitute check contains an accurate image of the front and back of the original check and a legend stating that it is the legal equivalent of the original check, and (2) no depository bank, drawee, drawer, or indorser will be asked to pay a check that it already has paid. A substitute check that meets the Check 21 Act's requirements regarding accuracy, bears the legend, and for which a bank has made the substitute check warranties is the legal equivalent of the original check for all purposes and all persons.

The use of legally equivalent substitute checks should facilitate collection and return of checks in electronic form. For example, a depository bank in California that receives a check drawn on a bank in New York now must send the original paper check for collection unless it, or an intermediary collecting bank that presents checks sent by it, has an electronic presentment agreement with the paying bank. Under the Check 21 Act, by contrast, the California bank could transfer check information electronically to a collecting bank in New York with which it had an

agreement to do so. The New York collecting bank then could create a substitute check to present to the New York paying bank. The New York paying bank would be required to take presentment of a substitute check that met all the legal equivalence requirements. Thus, instead of processing and transporting the original check across the country, the California bank could collect the substitute check using only local New York transportation.

*II. How the Check 21 Act Affects Banks**A. In General*

Although the Check 21 Act is designed to enable more efficient use of electronic check processing by allowing use of one piece of paper in place of another, the law does not require any bank to use electronic check processing, receive electronic presentment, or create a substitute check. The Check 21 Act also does not make electronic check images or electronic check information the legal equivalent of an original check. Moreover, the Check 21 Act does not alter existing arrangements under which banks agree to return paid paper checks to account holders with periodic account statements. However, after the effective date of the Check 21 Act, account holders that receive paid checks with their statements may receive a mix of original checks and substitute checks.

The characteristics of a substitute check are such that a bank receiving a substitute check would be able to process that substitute check to the same extent that it could process the original check. As a result, banks would not be required to change their check processing equipment because of the Check 21 Act, and, except as described in the next section, there would be no need for a bank to treat original checks and substitute checks differently during the check collection and return process. Because a legally equivalent substitute check contains an accurate representation of the information on the original check and all indorsement information associated with the check, drawers and other persons should be able to rely on a substitute check just as they would an original check for other purposes, such as proof of payment.

B. Provisions Affecting All Banks

Certain provisions of the Check 21 Act will affect all banks, even those that do not choose to create substitute checks. For example, any bank that transfers, presents, or returns a substitute check (or a paper or electronic representation of a substitute check) for consideration would make

² Some paying banks and bank customers prefer to receive checks in paper form for operational or other reasons.

³ Pub. L. 108-100, 117 Stat. 1177 (codified at 12 U.S.C. 5001-5018). The Check 21 Act was enacted on October 28, 2003, and takes effect on October 28, 2004.

¹ See, e.g., section 3-501(b) of the Uniform Commercial Code.

the substitute check warranties and would be responsible for indemnifying any person that suffered a loss due to the receipt of a substitute check instead of the original check. A bank that transferred a substitute check to a consumer who incurred a loss associated with the substitute check also might be required to provide an expedited recredit to that consumer. A bank that provides paid checks to consumer customers with periodic account statements or that otherwise provides a substitute check to a consumer customer must provide a disclosure that describes substitute checks and substitute check rights.

Although the Check 21 Act does not require banks to make processing changes to receive substitute checks, a bank will be required to qualify a substitute check for return differently than it does an original check. A bank must place a "2" in position 44 of the MICR line of a qualified returned original check. A bank that qualifies a substitute check for return instead must encode position 44 of the substitute check's qualified return MICR line with a "5."

C. Provisions Affecting Banks That Create Substitute Checks

Although the foregoing provisions of the Check 21 Act would apply to all banks, the law is designed so that losses associated with a substitute check ultimately would be borne by the party that first transferred, presented, or returned the substitute check (the reconverting bank).⁴ A bank that paid a warranty claim or provided an indemnity or expedited recredit for a substitute check that it received from another bank could, in turn, bring a warranty, indemnity, or interbank expedited recredit claim against the bank that transferred the substitute check to it and thereby pass the associated loss back to the reconverting bank.⁵ Thus, if there is a duplicative check payment involving a substitute check, a substitute check indemnity claim, or a breach of the legal equivalence warranty, the Check 21 Act places ultimate responsibility on the

reconverting bank.⁶ The Check 21 Act also requires the reconverting bank to identify itself as such and to preserve the indorsements of parties that previously handled the check in any form.

III. Overview of the Board's Proposed Rule

The Board in January 2004 proposed to implement the Check 21 Act by adding to Regulation CC a new subpart D that would incorporate the requirements of the Act applicable to banks that create, receive, or provide substitute checks or paper or electronic representations of substitute checks.⁷ The Board proposed that subpart D would contain provisions concerning requirements a substitute check must meet to be the legal equivalent of an original check, reconverting bank duties, the warranties and indemnity associated with substitute checks, expedited recredit procedures for consumers and banks, liability for violations of subpart D, and the interaction between subpart D and existing federal and state laws. The Board proposed new model notices in appendix C for the consumer awareness disclosure and other consumer notices regarding substitute checks.

The Board also proposed amendments to implement the Check 21 Act that would affect some existing provisions of Regulation CC and its commentary. For example, the Board proposed to supplement some existing defined terms in § 229.2 for which the Check 21 Act had slightly different definitions and to define several new terms used in subpart D. The Board also proposed to amend the magnetic ink character recognition (MICR) line requirements for qualified returned checks to allow for differences to facilitate the processing of substitute checks and to amend § 229.35 and appendix D to include indorsement and identification standards for substitute checks.

The Board also proposed revisions to several other provisions of Regulation CC and its commentary that were unrelated to the Check 21 Act. For example, the Board proposed amending the commentary to clarify that a returned check notice need not be written, clarify the application of the Electronic Signatures in Global and National Commerce Act (the E-Sign Act) to consumer disclosures that Regulation CC requires to be in writing, and clarify the time by which a paying bank may extend the return or notice of nonpayment deadline. The Board also

sought general comment on several issues, including whether it should include in Regulation CC a new U.C.C. warranty regarding the drawer's authorization of remotely-created demand drafts.

Overview of Comments on the Proposed Rule

The Board received comments on the proposed rule from 168 commenters, including 107 depository institutions and organizations representing depository institutions, 35 consumers and consumer groups, 14 nonbank service providers, and 12 other organizations and persons (including one United States Senator). The vast majority of these commenters generally approved of the Check 21 Act and the Board's proposed rule but expressed views about how the Board could change specific provisions of the rule. Specific substantive comments are discussed in more detail in the portions of the Section-by-Section Analysis that analyze the commented-upon provisions.

I. Comments Expressing General Concerns

Several commenters expressed general disapproval of the Check 21 Act and the Board's proposed rule. These commenters expressed concern that the use of substitute checks would increase fraud, benefit banks at the expense of consumers, and confuse consumers and bank employees.⁸

The commenters concerned about consumer harm argued that the Check 21 Act would shorten the time needed to collect checks and would not reduce fees for consumers.⁹ The Board expects that the Check 21 Act ultimately will decrease the time needed to collect checks, which is an outcome that the Board deems desirable, and will result in other benefits to banks and their

⁴ A reconverting bank is (1) the bank that creates a substitute check or (2) the first bank that receives a substitute check created by a person that is not a bank and transfers either that substitute check or in lieu thereof the first paper or electronic representation of that substitute check.

⁵ Banks may further allocate liability amongst themselves as part of their agreements to handle checks electronically. A reconverting bank that received a check in electronic form therefore could, by agreement, pass back to the sender of that item some or all of the losses the reconverting bank incurred if it used the electronic item to create a substitute check that gave rise to a Check 21 Act warranty, indemnity, or expedited recredit claim.

⁶ But see footnote 5.

⁷ 69 FR 1470 (Jan. 8, 2004).

⁸ Some commenters argued that banks would be unable to make an informed decision about whether to process checks physically or switch to electronic processing because of uncertainty about the relative costs of each option. There are a variety of factors in determining the relative costs of check processing options, some of which are institution-specific. The Board expects that most banks should be able to analyze their own cost structures and make informed processing decisions.

⁹ Some commenters also expressed concern that existing hold periods for deposited checks were either too long or too short. The existing hold periods in subpart B of Regulation CC are those set forth in the Expedited Funds Availability Act, and the Board is required to shorten (but may not lengthen) those hold periods as the time periods for clearing local and nonlocal checks improve on a widespread basis. The Board will adjust the hold periods in subpart B if and when the check clearing timeframes for checks improve substantially enough to warrant such adjustments.

customers.¹⁰ For example, processing changes that a bank makes in reliance on the Check 21 Act could enable the bank to offer its depositors later cutoff times for certain deposits or to make check images available to consumers online. These changes would allow consumers faster access to deposited funds and to records relating to their check payments, respectively.

Several commenters noted that people already are confused because some checks are used to obtain information to initiate an automated clearing house (ACH) debit rather than to effect the payment transaction by check. These commenters expressed concern that adding substitute checks to the payment system would exacerbate confusion about the rights associated with checks. The Board agrees with commenters that substitute checks could increase confusion about the ways in which checks can be used to process payments and the legal rights associated with each processing choice. The Board plans to prepare guidance on these topics.

II. Comments Urging Action Inconsistent With the Check 21 Act

Several commenters suggested that the Board take actions that would be inconsistent with the language or intent of the Check 21 Act.

Three commenters suggested that the Board delay the effective date of the rule beyond the effective date of the statute. However, to implement the Check 21 Act effectively, the rule generally must take effect no later than the effective date of the statute.¹¹

One commenter suggested that the Board establish standards for the exchange of electronic check images. This would go beyond the scope of the provisions of the Check 21 Act, which only relate to substitute checks. Electronic presentment will continue to be governed, as it is today, by agreements between the paying bank and the presenting bank.¹²

¹⁰ The more time needed to collect a check, the greater the risk that the depository bank will make funds deposited by check available for withdrawal before it knows whether the paying bank will pay or return the check. The Board's policies therefore seek to reduce, rather than preserve, the time for collecting checks. See, e.g., the Board's Policy Statement on Delayed Disbursement, Fed. Res. Reg. Service ¶ 9-750, p. 9-247.

¹¹ Model disclosure C-5A in appendix C takes effect immediately so that banks need not delay their use of that model in preparing the consumer awareness disclosure required by § 229.57. The requirement in appendix D that all indorsements be printed in black ink does not take effect until January 1, 2006, to give banks a transition period to make necessary processing changes.

¹² One commenter suggested that the Federal Reserve Banks publish a list of banks that have agreed to send or receive checks in electronic form.

Another commenter opined that the costs of using substitute checks should be borne by paying banks and bank customers that demand paper checks. This would be at odds with the Act's intent to allow banks that choose to process checks electronically to do so and create substitute checks in a manner that is transparent to banks and other persons that require paper checks.

Several commenters expressed particular concern that the use of substitute checks would make the original check more difficult to obtain, which in turn would impede law enforcement's ability to obtain physical evidence, such as fingerprints, pen pressure analysis, and other forensic evidence from paper checks.¹³ These commenters requested that the Board impose original check retention requirements in subpart D. Original checks are truncated in today's environment, and the U.C.C. requires the person that truncates the check to give the original check to the drawer, keep the original check, or destroy the original check but maintain the ability to provide a legible copy for a specified period of time (usually seven years). The Board expects that, after the Check 21 Act takes effect, more checks potentially will be truncated and destroyed. The Check 21 Act does not impose any additional requirements on original check retention, and the Board is not imposing any such requirements by regulation. Rather, the choice of whether, and after what period of time, to destroy a check will remain a business decision for the bank or other person that removes the check from the collection or return process. Banks and other persons that destroy checks may take fraud risks into account when deciding whether to destroy a truncated check. For example, some banks may choose to keep original checks above a certain dollar amount due to the potentially greater risks associated with those items.

Reserve Banks and other collecting banks may publish lists of banks that accept electronic presentment from them. However, any such lists will reflect only the agreements of the listed banks to receive presentment electronically from that particular collecting bank and would not indicate a general agreement of the receiving bank to receive presentment electronically.

¹³ The commenters did not quantify how often or how many checks are used for forensic purposes by law enforcement; however, the Board understands from staff of the Financial Management Service of the Department of Treasury that cases in which examination of an original Treasury check is necessary to determine a fraud or forgery are relatively rare.

III. Comments That Misunderstood the Check 21 Act or the Board's Proposed Rule

The Board received numerous comments that indicated confusion about the scope, requirements, or effects of the Check 21 Act or the proposed rule.

Fourteen individuals expressed concern that the Act would preclude them from receiving paper checks with their periodic account statements, and four individuals stated that consumers should be able to stop banks from converting their checks to substitute checks. The Check 21 Act does not preclude arrangements whereby customers receive paid checks, although it does make a substitute check acceptable for that purpose.

Two other commenters argued that the Act and the proposed rule would make it more difficult to comply with requirements to produce original checks and suggested that the Board confirm that the Internal Revenue Service (IRS) would accept substitute checks or full-sized photocopies for tax purposes. Substitute checks that meet the legal equivalence requirements of the Check 21 Act can, by the terms of the Act, be used wherever an original check is required. The Board also notes that the IRS currently allows documents other than original checks to be used for tax purposes.¹⁴

Three commenters asked the Board to ensure that banks' implementation of electronic check processing services as contemplated by the Check 21 Act would not impede nonbanks' ability to arrange for checks deposited at disparate locations to be returned to a single location. A check is returned to the bank whose routing number appears in the depository bank indorsement on the back of the check. To facilitate banks' ability to receive returned checks at a centralized location, § 229.35(d) of Regulation CC permits banks to agree that the depository bank indorsement applied to the back of the check can be the indorsement of a bank other than the bank into which the check was deposited. The Check 21 Act and the Board's final rule do not affect § 229.35(d), and the Board accordingly expects centralized returned check arrangements to function with respect to substitute checks just as they do with respect to original checks today. The Board also notes that industry standards include fields within electronic check records that are specifically designed to

¹⁴ See, e.g., IRS Publication 552—Recordkeeping for Individuals, which discusses the permissibility of account statements to prove payments made by check, credit card, or electronic fund transfers.

facilitate centralized check return programs.

Another commenter was concerned that the Act and subpart D would impede banks' ability to use "positive pay" and "positive payee" programs to detect fraud. Under a positive pay program, a bank compares the check number and amount of a presented check against a list of check numbers and amount information provided by the drawer. The use of a substitute check should not affect this program. In a positive payee program, the drawer identifies the payee of a check, and the bank scans the payee field of a presented check to verify that the payee information is correct. The payee information on a substitute check will appear in a different location than on an original check, because the image of the original check is reduced and shifted when it is placed on a substitute check. However, position 44 of the MICR line of a substitute check is required to bear a "4" for forward collection or a "5" for qualified return. This information should allow the paying bank's check-processing equipment to identify the document being scanned as a substitute check and to adjust the location at which it scans the payee field accordingly.

Overview of the Board's Final Rule

The Board's final rule is substantially similar to the rule that the Board proposed for comment. However, the Board has made a number of clarifying changes in response to comments received and its own further analysis. These changes include adjustments to certain definitions, particularly regarding how MICR-line variations affect a document's status as a substitute check. The commentary to the final rule provides further clarification about the flow of responsibility for the warranties and indemnity. In addition, the final rule clarifies the scope of, and timeframes that apply to, expedited recredit claims and the general consumer awareness notice requirement. The Board also has provided additional commentary in response to comments that indicated confusion about the interaction between particular provisions of the Check 21 Act and particular provisions of the U.C.C.

Section-by-Section Analysis

This section-by-section analysis focuses on the provisions of the rule that the Board changed or considered changing in light of comments or the Board's further consideration. This analysis does not discuss provisions of the final rule that are substantially

similar to the corresponding provision of the proposed rule and on which the Board received no substantive comment. Regarding the Board's reasoning for those provisions, the section-by-section analysis of the Board's proposed rule is incorporated by reference.

I. Amendments To Implement the Check 21 Act

A. Definitions and Word Usage

1. *In General.* Three commenters suggested that the final rule should use terms that are defined in Articles 3 and 4 of the U.C.C. in a manner consistent with the U.C.C.'s usage of those terms. The commenters argued that to do otherwise would produce uncertainty and increase the likelihood of litigation. In particular, these commenters stated that the commentary of the proposed rule used the terms accept and party in ways not contemplated by the U.C.C. The Board agrees that subpart D's word usage should be consistent with the U.C.C. The final rule and commentary therefore replace the word accept with more appropriate verbs, such as take or receive, and replace the word party with person where subpart D contemplates a meaning of the term party that is different from the meaning in the U.C.C.

2. *Section 229.2(a) Account; Section 229.2(n) Consumer Account.* Four commenters expressed concern about aspects of the Board's proposed definitions of account and consumer account.

One commenter suggested that the Board's expansion of the definition of account to include any deposit account at a bank for purposes of subpart D was inappropriately broad. The broad account definition for purposes of the Check 21 Act and subpart D is statutory, and the final rule retains it. Although the Board has not substantively modified the account definition, it has revised the language of the rule and commentary to distinguish more clearly accounts for purposes of subpart D from accounts for purposes of the other subparts of Regulation CC.

One commenter expressed confusion about when interbank deposits would be excluded from the account definition. Existing Regulation CC excludes interbank accounts for purposes of all subparts of Regulation CC. However, the context in which subpart C uses the term account clearly indicates that interbank accounts are meant to be included within that term. The final rule retains the proposed rule's exclusion of interbank accounts for purposes of only subpart B and, in connection therewith, subpart A. The commentary to the final rule explicitly

notes that interbank deposits are included in the account definition for purposes of subparts C and D.

To determine when a consumer awareness notice would be necessary, one commenter asked whether the term consumer account included an omnibus clearing account held by a brokerage firm at a bank for purposes of allowing the brokerage firm to pay checks drawn by consumers. The commentary to the final rule clarifies that this type of account is not a consumer account. The commentary to the consumer account definition also clarifies that a credit card account or home equity line of credit that a consumer can access by check is not a consumer account for purposes of Regulation CC because in those cases the consumer's relationship with the bank is a loan rather than a deposit relationship.

3. *Section 229.2(m) Check Processing Region.* One commenter stated that the commentary to § 229.2(m) erroneously states that there are 46 check processing regions. A check processing region is defined as the area served by a Reserve Bank's main office, branch, or other office for check processing purposes. Because the number of Reserve Bank locations that process checks is not static, the final rule omits any numerical reference.

4. *Section 229.2(z) Paying Bank.* One commenter expressed concern that the proposed rule's definition of paying bank stated that the Treasury of the United States or the U.S. Postal Service was a paying bank for a check payable by that entity and sent to that entity for collection, whereas the statutory definition states that these entities are paying banks to the extent that they act as payors. The commenter expressed concern that the proposed rule's definition could be read to exclude Treasury checks and postal service money orders that are sent to Federal Reserve Banks for collection rather than sent directly to the Treasury or the U.S. Postal Service.

The proposed amendment to the paying bank definition was intended to parallel the construction of the existing definition and not to alter the meaning of the Check 21 Act's definition. The final rule retains the proposed definition. The Board has amended the commentary to the definition to clarify that, because the Federal Reserve Banks act as fiscal agents for the Treasury and U.S. Postal Service, Treasury checks and U.S. Postal Service money orders that are sent to the Reserve Banks for collection are deemed to be sent to the Treasury or the U.S. Postal Service, respectively.

5. *Section 229.2(ww) Original Check.* One commenter expressed confusion about the proposed definition of original check and stated that the definition could be read to mean that only one substitute check could be created with respect to any original check. As indicated in the proposed rule and commentary, the Board defined the term original check to distinguish the first paper item authorized by the drawer from any later electronic file or substitute check that represents that item. The Board has left the definition unchanged but has provided commentary to clarify that multiple substitute checks could be created at various points in the collection and return process to represent the same original check.

6. *Section 229.2(vv) MICR Line.* The final rule identifies the applicable industry standards for MICR-line printing and adds a sentence to the commentary to highlight that those standards can vary the technical aspects of printing the MICR line. This would include, for example, the circumstances under which magnetic ink is not required. This revision responds to comments suggesting that a bank not be required to use magnetic ink when printing a paid substitute check solely for the purpose of providing it to the account holder.

7. *Section 229.2(xx) Paper or Electronic Representation of a Substitute Check.* The phrase "paper or electronic representation of a substitute check" was used at many points of the proposed rule and commentary, particularly with respect to the flow of the warranties and indemnity. Several commenters expressed confusion about the need for this phrase or asked that the Board provide more detail about what types of documents or files were included within its scope.

The statute intends that the chain of banks that make the warranties and indemnity will flow uninterrupted from the first reconvert bank to the claimant regardless of how many times the form of the item changed after creation of the first substitute check. The phrase "paper or electronic representation of a substitute check" ensures that responsibility for the warranties and indemnity will flow from the reconvert bank to the last bank that for consideration transfers, presents, or returns the substitute check or representation thereof. The phrase also ensures, as contemplated by the statute, that drawers will have the ability to make a warranty claim under the Check 21 Act even if they received a paper or electronic representation of a substitute check instead of a substitute

check. The final rule therefore defines the phrase, and the commentary to the new definition provides examples to illustrate its scope.

8. *Section 229.2(zz) Reconvert Bank (corresponding to Section 229.2(yy) of the proposed rule).* Several commenters expressed concern about the proposed definition of reconvert bank and the accompanying commentary.¹⁵ Most of these comments focused on the portion of the definition describing the identity of the reconvert bank when a nonbank created the substitute check.

A few commenters opined that the rule should prohibit a person other than a bank from creating a substitute check. However, the statutory text defining a reconvert bank explicitly contemplates nonbank creation of a substitute check, because it states that a bank can be a reconvert bank if it is the first bank to transfer or present a substitute check created by a person other than a bank. The legislative history also explicitly states that Congress intended to allow nonbanks to create substitute checks.¹⁶ The Board therefore has retained the portion of the definition pertaining to nonbank creation of substitute checks.

One commenter was confused by the provision in the proposed rule that a bank receiving a substitute check for deposit from a nonbank would be the reconvert bank if, in lieu of the substitute check, that bank transferred the first paper or electronic representation of the substitute check. This provision ensures that ultimate responsibility under the Act for the substitute check warranties and

¹⁵ One commenter was confused that the rule used the term reconvert, rather than convert, bank. Reconvert bank is the statutory term and reflects the fact that the original check is converted to electronic form and then later reconverted back to a paper substitute check.

¹⁶ When discussing circumstances under which the substitute check warranties are made, the House Report on the Check 21 Act states as follows:

The Committee intends that this language allow depositing customers of a bank to create substitute checks with the same legal protections for recipients under this legislation as if they had been converted by a financial institution at the point of first deposit. If a bank allows its depositing customer to create substitute checks, the bank is warrantor for the substitute checks created by its depositing customer. For example, if a grocery store creates a substitute check, the bill makes the grocery store's bank, and not the grocery store, responsible for the section 4 warranties. A bank may choose to pass along, by agreement with the depositor that creates the substitute check, any liability it may incur due to the depositor in this regard. The Committee believes that requiring a bank's credit to stand behind a substitute check will provide strong protections when paper checks are removed from the system at the point of sale or purchase before they are deposited at, or presented to a financial institution. H.R. Rep. No. 108-132, at 17 (2003).

indemnity will flow back to the bank that received the substitute check from the nonbank. Without this provision, if a bank received a substitute check but instead transferred an electronic representation of that substitute check and a subsequent bank created a second substitute check, that second bank would not be able to pass back losses under the Act to the initial depository bank. The final rule therefore retains the proposed provision.

Several commenters expressed concern about the potential for a bank to become a reconvert bank without its knowledge and consent. For example, commenters were concerned that a nonbank customer could create and deposit a substitute check without first consulting the bank about its willingness to accept substitute checks in lieu of original checks. The first bank that transfers, presents, or returns a substitute check created by a nonbank (or in lieu therefore the first paper or electronic representation of that substitute check) is the reconvert bank regardless of whether it explicitly agreed to do so. However, generally only large corporate depositors would be equipped to create and deposit substitute checks. Banks therefore should be able to address this issue through their deposit agreements.

One commenter requested that the commentary to the reconvert bank definition provide an example about the identity of the reconvert bank if a bank used a nonbank service provider to create a substitute check on its behalf. The proposed rule already had such an example and the final rule retains it with minor revisions. The Board also has revised the proposed commentary to describe more clearly how to identify the reconvert bank for a check created by a nonbank and to provide additional examples about when a bank would or would not be a reconvert bank.

9. *Section 229.2(aaa) Substitute Check (corresponding to Section 229.2(zz) of the proposed rule).*

a. *General Comments.* One commenter stated that the industry standard for substitute checks supported substitute checks as well as other types of "image replacement documents," such as photocopies in lieu of the original check. The commenter requested clarification about whether the other types of documents contemplated by the standard would be substitute checks.

At the time of the proposed rule, the draft standard developed by the Accredited Standards Committee X9 and approved for trial use by the American National Standards Institute

was labeled ANS X9.90 and contemplated three different types of documents, one of which was the substitute check that the Check 21 Act authorizes. Going forward, this standard will be known as ANS X9.100–140 and apply only to substitute checks. However, any document that met all the requirements of 229.2(aaa) would be a substitute check.

Nine commenters expressed concerns about the image standards and other quality standards that apply to substitute checks. Three commenters suggested that the Board identify or give examples of industry standards for substitute checks, and one commenter suggested that the industry standards for substitute checks that the Board identified should not disrupt existing industry standards for checks. The proposed commentary to the substitute check definition identified ANS X9.90 as the industry standard for substitute checks. Because that standard was renamed, the final rule identifies the industry standard for substitute checks as ANS X9.100–140 (unless the Board by rule or order determines that a different standard applies), notes that that standard is exclusive standard, and further notes that ANS X9.100–140 incorporates by reference other existing generally applicable industry standards for checks. The Board has included the “unless the Board by rule or order determines that a different standard applies” language to indicate specifically that the Board ultimately determines what standard applies to substitute checks. The Board does not expect to change the identified standard. In the unlikely event that the Board does identify a different standard, it almost certainly would do so by amending Regulation CC. The Board in no case would change the standard without providing notice of such change.

Three commenters requested that the Board establish standards regarding image quality for substitute checks. In particular, these commenters suggested that substitute checks should be required to use gray-scale, as opposed to black-and-white, images. The Board believes that this level of detail is more appropriately left to industry standards. Although ANS X9.100–140 does not prescribe image standards, that standard may evolve as the industry gains more experience with substitute checks.

A few commenters had particular questions about how the image of the original check would be applied to a substitute check. Two of these commenters erroneously believed that a second substitute check would contain an image of the full front and back of the

previous substitute check. Persons wishing to obtain detailed information regarding the layout of a substitute check should consult ANS X9.100–140. This standard generally provides that the images of the front and back of the original check will be reduced so that they can be placed on the first substitute check. A subsequent substitute check would not contain an image of the entire first substitute check. Rather, a subsequent substitute check would contain the image of the original check as that image appeared at the time the previous substitute check was converted to electronic form, and the remainder of the front of the second substitute check would contain identification, MICR-line, and legend information applied by the second reconverting bank. By contrast, the back of a subsequent substitute check would contain an image of the full length of the back of the previous substitute check in order to preserve previous indorsements. The commentary to the substitute check definition and the commentary to § 229.35 regarding indorsement requirements explain image and indorsement requirements for later-generation substitute checks in detail.

b. *Substitute Checks and ACH Debits.* Several commenters requested clarification about how, if at all, checks that are used as source documents to create ACH debits are covered under the Check 21 Act, particularly whether such checks can be used to create substitute checks.

A substitute check must be a representation of an original check. Therefore, something that is not an original check cannot be reconverted to a substitute check. The final rule defines an original check as the first paper check issued with respect to a particular payment transaction. Under U.C.C. 3–105, a check is issued when it is delivered by a drawer with the purpose of giving rights on the check to any person.

The drawer's authorization regarding the use of a check it provides to initiate an ACH debit will determine whether the drawer has issued the check within the meaning of Regulation CC and thus whether the check may be used to create a substitute check. If the drawer authorizes the check only to be used as a source document for an ACH debit and does not authorize the check to be collected as a check, then the check has not been issued because it has not been delivered in a manner that gives any person rights on the check. Therefore, a check authorized for use solely as an ACH debit source document is not an original check within the meaning of

Regulation CC, and a bank cannot create a substitute check from that document.

c. *MICR-line Requirement.* The Board's proposed rule adopted the statutory definition of substitute check without substantive change, although the commentary provided extensive discussion of how the MICR line of a substitute check could vary from the MICR line of the original check. Specifically, the proposed commentary clarified that (1) position 44 of the MICR line must contain a “4” or a “5,” (2) a bank could correct an encoding error that appeared on the original check when applying a MICR line to the substitute check, (3) a bank could encode an amount on the substitute check if the original check's MICR line did not contain that information, and (4) no other variation from the original check's MICR line would be permitted. The proposed commentary highlighted that an impermissible error could be caused, for example, if a check reader-sorter misread or failed to read the MICR line of the original check, causing the MICR line applied to the substitute check to contain an error that did not appear on the original check. The proposed rule further provided that a document that failed to meet the substitute check definition only because of a MICR-line error (*i.e.*, a document that “purported” to be a substitute check) would be treated as if it were a substitute check for purposes of the liability and consumer-related provisions of subpart D but would not be the legal equivalent of the original check.

The Board received comments on its proposed treatment of the MICR-line component of the substitute definition from numerous commenters, most of which were depository institutions or organizations representing depository institutions. Some of these commenters generally approved of the MICR-line clarifications and the related purported substitute check provision proposed by the Board. However, the vast majority of commenters on these issues disagreed with the proposed approach.

Commenters that disagreed with the proposed rule expressed concern that the proposed commentary would create confusion because it would allow substitute check MICR lines to contain some variations from the original check but not others. These commenters also expressed concern that paying banks could not charge a customer's account for a document that was not a substitute check because of a MICR-line error and therefore not the legal equivalent of the original check. These commenters advocated that a document with any MICR-line error should be a substitute

check that could be the legal equivalent of the original check. Commenters also stated that the proposed rule provided insufficient guidance about (1) the requirement for encoding position 44 of the MICR line on a qualified return substitute check, (2) whether a bank that failed to encode a substitute check properly would be liable under the Check 21 Act or existing encoding warranties, and (3) which bank ultimately would bear liability for substitute check encoding errors. Many of these commenters suggested that encoding of substitute checks should be covered by existing encoding warranties. Commenters opposing the Board's proposed treatment of the MICR-line requirement also expressed concern that the proposed rule inadequately addressed the extent to which banks could repair a MICR-line error. These commenters generally indicated that the rules for repairing the MICR line of a substitute check should parallel as closely as possible the rules for repairing the MICR line of an original check.¹⁷

The MICR-line component of the substitute check definition in the Check 21 Act provides that a substitute check is a paper representation of an original check that "bears a MICR line containing all the information appearing on the MICR line of the original check, except as provided under generally applicable industry standards for substitute checks to facilitate the processing of substitute checks."

ANS X9.100-140 requires a substitute check used for forward collection to bear a "4" in position 44 and a qualified returned substitute check to bear a "5" in that position. Proper encoding of position 44 ensures that downstream banks will be on notice that the document they have received is a substitute check and can, if converting such an item to electronic form or qualifying it for return, handle it appropriately. The final commentary to the substitute check definition therefore clarifies that a reconverting bank or a bank qualifying a substitute check for return must encode position 44 with a "4" or a "5," as appropriate.

The final rule clarifies that a substitute check MICR line must have

information in each field of the MICR line that was encoded on the original check at any time before an image of the original check was captured. This would include all of the information preprinted on the original check, plus any additional information, such as the amount, that was encoded prior to the time the image of the original check was captured.

In light of the highly technical nature of the MICR line and its important operational role in check processing, the Board's final rule leaves the details regarding permissible MICR-line variations up to ANS X9.100-140 instead of identifying them in the rule and commentary. The Board believes that allowing the MICR line of a substitute check to vary from the original check's MICR line as specified in ANS X9.100-140 is appropriate because the full range of issues relating to MICR-line errors and the most practical solutions to those issues will be revealed through operational experience with substitute checks.

The Board expects that the variations from the original check's MICR line permitted by ANS X9.100-140 would be kept to the minimum necessary to facilitate substitute check processing in the same manner as the original checks. Such variations could include, for example, allowing reconverting banks to correct errors appearing on the MICR-line of the original check. The commentary to the final rule clarifies, however, that industry standards cannot allow a substitute check MICR line to omit a field that, at any time prior to truncation, was encoded on the original check's MICR line. The Board further expects that, in determining what variations from the original check's MICR line should be permitted, the standards committee will incorporate the overriding goal of the Check 21 Act that substitute checks should function as much as possible like original checks so that paying banks and other persons that demand paper checks will not bear costs associated with receiving a substitute check instead of an original check. If the Board concludes that the variations permitted by ANS X9.100-140 are inconsistent with this or other purposes of the Check 21 Act, the Board will consider identifying permissible MICR-line variations by rule or order instead of relying on ANS X9.100-140.

Through revisions to § 229.34(c)(3) and its commentary, the final rule provides that application of MICR-line information to a substitute check is subject to Regulation CC's encoding warranties. The commentary to the substitute check definition also notes that, once a document that meets the

substitute check definition has been created, banks may apply MICR-encoded strips to that document as necessary to complete the collection and return process.

10. *Section 229.2(bbb) Sufficient Copy and Copy (corresponding to § 229.2(aaa) of the proposed rule).* The final rule's definition of sufficient copy more closely tracks the statutory language in the indemnity section of section 6(d)(1) of the Check 21 Act than did the proposed rule. The Board also has reorganized and revised the commentary to illustrate more clearly the definitions of copy and sufficient copy.

Several commenters were confused about the relationship between copy and sufficient copy, which are defined as paper documents, and § 229.58, which allows banks to provide information electronically if the recipient agrees. Although the terms copy and sufficient copy, as well as the term original check, refer only to particular pieces of paper, a bank that is required to provide a paper check or copy may satisfy that requirement by instead providing an electronic image of the check or copy in accordance with § 229.58.

11. *Section 229.2(ccc) Transfer and consideration (corresponding to Section 229.2(bbb) of the proposed rule).* In response to a comment, the Board has revised the definition of consideration to clarify that a bank receives consideration for the substitute check (or paper or electronic representation thereof) that it transfers to a nonbank if the bank has received value for the check in that or any other form.

The proposed rule contained an exception from the consideration definition stating that a bank would not receive consideration for a substitute check solely in response to a warranty, indemnity, expedited recredit, or other claim with respect to the substitute check. The Board proposed this exception so that a bank could respond to an indemnity or expedited recredit claim by providing a substitute check without a legal equivalence legend as a sufficient copy without automatically breaching the legal equivalence warranty. Several commenters were confused about the operation of this exception. The Board has deleted the exception from the final rule. Because industry standards require application of the legal equivalence legend to a substitute check, the problem that the exception was designed to address is not likely to arise in practice. Moreover, on further consideration, the Board believes that it would be appropriate for a substitute check provided in response

¹⁷ In response to the many concerns expressed about the Board's proposed treatment of the MICR-line replication requirement, the Board's staff invited commenters that addressed MICR-line issues to a meeting to explore these issues further. The meeting took place on May 3, 2004, at the Board, and representatives of 53 commenters attended in person or by conference call. A summary of this meeting, including a list of participants, is available at www.federalreserve.gov/SECRS/2004/May/20040625/R-1176/R-1176_150_1.pdf.

to a claim to carry full warranty, indemnity, and recredit rights.

12. *Section 229.2(ddd) Truncate; Section 229.2(eee) Truncating Bank (corresponding to sections 229.2(ccc) and 229.2(ddd) of the proposed rule, respectively).* Several commenters expressed concern about the definitions of and commentary to truncate and truncating bank. For example, one commenter expressed concern that the definition of truncate would preclude banks from truncating items that are not handled on a cash basis. Another commenter suggested that the Board clarify that a truncating bank does not make the substitute check warranties and indemnity under §§ 229.52 and 229.53, but that a bank receiving a check electronically could by agreement pass back to the truncating bank losses that the recipient bank incurred under those sections.

The proposed rule used the statutory definition of truncate, and the final rule retains that definition. However, the Board has amended the commentary to truncating bank to clarify that a bank receiving a check electronically from the truncating bank may pass back losses by agreement.

B. Section 229.30(d) Identification of Returned Checks

Section 229.30(d) requires a paying bank to identify its reason for returning a check unpaid on the front of the returned check but does not require a specific location for that information. The Board has revised this section and the accompanying commentary to clarify that a paying bank that returns a substitute check must place the reason for return within the image of the original check. This requirement ensures that the reason for return would be retained on any subsequent substitute check.

C. Issues Relating to Indorsement and Identification Standards—Sections 229.35 and 229.38 and Appendix D

The Board proposed to require all indorsements to be in black ink and to make depositary bank name/location information optional as opposed to mandatory. The Board requested comment about whether returning banks should retain the option to indorse a check on the front. The Board proposed applying to existing substitute checks the indorsement standards in § 229.35 and appendix D, with proposed amendments, that would apply to original checks. The Board proposed separate indorsement and identification requirements that would apply to reconverting banks at the time they create substitute checks.

The Board received a number of comments relating to its proposed treatment of indorsements. Several of these commenters generally questioned whether the proposed changes would improve the legibility of indorsements, particularly because some indorsements on substitute checks would be preserved through images of a previous item. The Board believes that it is too early to determine how the use of substitute checks ultimately will affect the legibility of indorsements. It is likely, as commenters stated, that more indorsements will be preserved through images of previous items. It also is likely that, as the efficiency of the collection process improves through wider use of electronic processing and substitute checks, fewer banks will handle and thus be required to indorse a check. A reduction in the number of indorsements on an item should contribute to greater legibility of the indorsements that are applied.

A few commenters stated that, in some cases, check-handling equipment would first capture an image of a check and then spray a physical indorsement on the check. These commenters requested that the Board clarify that in such cases the indorsement applied after the check image was captured would be conveyed as an electronic indorsement rather than an image of the physical indorsement. The Board agrees with these commenters' analysis of how such an indorsement would be carried forward and has revised the commentary to the substitute check definition and § 229.35 accordingly.¹⁸ The Board has made additional clarifying changes to these portions of the commentary to address questions posed by commenters regarding the application and preservation of indorsements.

Commenters generally agreed with the Board's proposal to require indorsements to be in black ink, although several indicated that requiring banks to switch from purple to black ink immediately would be burdensome and requested a grace period.¹⁹ The final rule retains the black ink requirement but delays the

¹⁸ One commenter requested clarification about how a second depositary bank should indorse a substitute check that was returned and redeposited. Substitute checks in such a case would be indorsed just as a redeposited original check is indorsed today.

¹⁹ One commenter suggested that the Board should delay the effective date for all the new reconverting bank indorsement and identification requirements. The requirement that a substitute check contain a reconverting bank identification is statutory and takes effect on the effective date of the Check 21 Act.

mandatory compliance date until January 1, 2006.

Three commenters stated that name and location information in the indorsement should be optional, while three others stated that many banks relied on that information and recommended that it remain mandatory. Three other commenters indicated that electronic indorsement standards did not provide for name/location information and suggested that the Board make name/location information mandatory for physically-applied indorsements but optional for electronically-applied indorsements. The final rule adopts this suggested approach.

A few commenters opined that indorsement on the front of the check would be useful under some circumstances, although they differed on what those circumstances would be. By contrast, the majority of commenters that addressed this issue stated that any indorsement on the front of the check would clutter the front of the check and potentially obscure other necessary information. To reduce the risk of obscuring information on the front of the check, the final rule provides that all indorsements must appear on the back of the check.

A few commenters stated that the new indorsement and identification standards with which a reconverting bank must comply when creating a substitute check were too detailed. The Board notes that, in general, the level of detail for indorsement location information for substitute checks at the time of creation parallels that for existing paper checks. The Board therefore has retained specific indorsement location information for newly-created substitute checks. However, the Board has removed specific location information for the reconverting and truncating bank identifications that appear on the front of the check and simply provided that such identifications must be outside the image of the original check. For purposes of the Check 21 Act, reconverting banks should be required to place this information on the front of the check in a manner that does not obscure necessary MICR-line and payment information. The Board believes that the precise location of that information is best left to industry standards.

A few commenters expressed concern that the reconverting bank and truncating bank identifications applied to the front of substitute checks would be considered acceptances or indorsements of such checks under the U.C.C. The Board therefore has clarified

in the commentary that identifications applied to the front of the check are not acceptances or indorsements. A reconverting bank that is a paying bank must place its routing number on the back of the check to ensure that its identification as a reconverting bank is not lost if there is a subsequent substitute check.²⁰ The Board also has clarified in the commentary to §§ 229.35(a) and 229.51(b) that this use of the paying/reconverting bank's routing number is for identification only and is not an indorsement.

The proposed rule contained amendments to the text of and commentary to § 229.38(d) to clarify a reconverting bank's liability for indorsements that, although applied in accordance with § 229.35 and appendix D, were illegible because of the reduction in size of the original check image that appeared on the first substitute check and the corresponding shifting in the placement of indorsements preserved within the image of the original check. Several commenters requested clarification about how this provision would work in practice. The final rule clarifies that the reconverting bank is liable if the reduction in size and placement of the original check image on the substitute check caused an indorsement previously applied to the original check in accordance with § 229.35 and appendix D to be rendered illegible by a subsequent indorsement that also was applied to the substitute check in accordance with those standards. The final rule also clarifies that the reconverting bank is liable if the shift in placement on a substitute check of an indorsement that was applied to the original check in accordance with § 229.35 and appendix D precluded the subsequent bank from legibly applying its indorsement to the substitute check in accordance with those standards.²¹

²⁰ One commenter questioned why a reconverting bank must apply its routing number twice to a substitute check. The routing number on the front of the substitute check identifies the bank as the reconverting bank for that particular check. The front of a subsequent substitute check thus would bear the routing number of the reconverting bank for that substitute check but not the routing number of the reconverting bank for the previous substitute check. A reconverting bank's routing number on the back of the check therefore serves both as its indorsement (except when the reconverting bank also is the paying bank) and also, because it is set off by asterisks, preserves its identity as a reconverting bank on subsequent substitute checks.

²¹ Subsequent substitute checks will contain an image of the entire back of the previous substitute check and therefore should not perpetuate the shifting indorsement problem.

D. Section 229.51 General Provisions Governing Substitute Checks

1. *Legal Equivalence.* Section 229.51 combined the legal equivalence and warranty concepts in sections 4(a) and 4(b) of the Check 21 Act by stating that a substitute check would be the legal equivalent of the original check for all purposes and all persons if (1) a bank had made the substitute check warranties in § 229.52 and (2) the substitute check accurately represented all the information on the front and back of the original check as of the time of truncation and bore the required legal equivalence legend.

a. *General Comments about Legal Equivalence.* The Board received several general comments about legal equivalence. One commenter agreed with the concept that a substitute check should not be legally equivalent to an original check unless the substitute check were subject to bank warranties. Two commenters opined that a substitute check created by a nonbank should not be a legal equivalent unless the first bank to transfer that substitute check explicitly agreed to do so. However, the definition of reconverting bank indicates that a bank that transfers a substitute check created by a nonbank thereby becomes the reconverting bank, even if that bank did not explicitly agree to accept the item. If such a substitute check met the accuracy and legend requirements for legal equivalence, it would become a legally equivalent substitute check as of the time the bank transferred it for consideration and thereby made the substitute check warranties. As discussed in the analysis of the reconverting bank definition, banks should be able to work with customers that wish to create and deposit substitute checks so that the banks do not become reconverting banks unwittingly.

b. *Accuracy of Information and Image Quality.* Commenters generally supported the concept that a substitute check must contain an accurate representation of all the information on the original check as a condition of legal equivalence. One commenter requested clarification that a substitute check need not be more legible than an original check to meet the legal equivalence requirements. The Board agrees that a substitute check is not held to a higher standard of accuracy in order to satisfy the legal equivalence requirements. The Board has clarified in the commentary that an accurate image of an illegible original check would, if all other requirements for legal equivalence were satisfied, be a legally equivalent substitute check. This commenter

further suggested that, if the back of the original check contained no indorsement information, only an image of the front of that item should be required for a substitute check associated with that item. The Check 21 Act defines a substitute check as a representation of an original checks that bears "an image of the front and back of the original check." A bank that creates a document without an image of the back of the original check and sends that document as if it were a substitute check therefore bears the associated risk of doing so.

Several commenters raised specific concerns about the proposed commentary to the accuracy requirement. The commentary to that requirement generally stated that "all the information" on the original check that must be retained includes the information preprinted on the original check, payment information added to the check, and other required information added to the check. Requiring features that do not survive the image capturing process to appear on a substitute check as a condition of legal equivalence would preclude the use of substitute checks, thus undermining the primary purpose of the Check 21 Act. The proposed commentary therefore noted that watermarks, micro printing, and other security features that cannot survive the imaging process need not be represented on a substitute check as a condition of legal equivalence.

Some commenters expressed concern about the loss of security features during the creation of a legally equivalent substitute check. Although the loss of some paper-based security features will be inevitable, the Board expects that the industry will develop additional security features that can survive the image capturing process.²² Other commenters expressed concern about whether the accuracy requirement for legal equivalence would be met if the drawer or a bank applied payment

²² One commenter expressed concern because the proposed commentary indicated that a latent security feature that became clearer after an image was captured (such as a void watermark that is faint on an original check but is revealed clearly on a photocopy or other image) would not cause a substitute check to fail the accuracy requirement, provided that it did not render any of the required information illegible. The presence of the void language on the substitute check is problematic to the extent that the recipient of the substitute check is unable to determine if the substitute check reproduced a fraudulent original item that contained clear void language before it was truncated or a legitimate original check on which the void language was latent. A person that suffered a loss because of this uncertainty would have an indemnity claim under § 229.53 and possibly an expedited recredit claim under § 229.54.

information to the check using an ink color or ink type that would not survive the image capturing process. The commentary to the final rule clarifies that payment information always must be accurately represented on a substitute check because that information is an essential element of a negotiable instrument. If a substitute check failed the legal equivalence requirement because of ink choice or some other feature, such as check color or a decorative image, the reconverting bank would be responsible for associated liabilities. However, a reconverting bank could attempt to address this issue through agreements with its depositors and the banks that send checks to it.

Several commenters expressed concern about the lack of uniform standards that apply to the image requirements for substitute checks. The Board understands that some banks intend to capture black and white images of items converted to electronic form, while other banks intend to capture gray scale images that contain a wider range of tones. Any substitute check that is subject to bank warranties, contains an accurate representation of the front and back of the original check, and bears the legal equivalence legend is the legal equivalent of the original check regardless of whether the image is black and white or gray scale. If issues relating to capturing images of checks prove problematic in the creation of substitute checks, the Board expects that industry standards would evolve to address those issues.

2. *Section 229.51(c) Applicable Law.* One commenter requested clarification about whether a substitute check that represented a fraudulent original check would have legal equivalence. The commentary to the final rule clarifies that such a substitute check, if it met the legal equivalence requirements, would be legally equivalent to the underlying check but as such would be treated in the same manner as the original fraudulent item for purposes of other law. For example, a bank could not properly charge a customer's account for a substitute check that represented a fraudulent original check.

This commenter also enquired about the legal status of a substitute check that did not meet the legal equivalence requirements. An item that meets the substitute check definition is a check even if it does not meet the additional requirements for legal equivalence. The proposed commentary to the check definition acknowledged that such substitute checks would be subject to the U.C.C. and Regulation CC. The final rule retains this sentence and, in

addition, amends the check definition to state specifically that the term check includes an original check and a substitute check.

3. *Purported Substitute Checks.* In the proposed rule, the Board recognized that some banks attempting to create a substitute check would instead create a document that failed to satisfy the MICR-line replication requirement to be a substitute check. The proposed rule referred to these documents as purported substitute checks. In many cases, a purported substitute check would be processed just like a check but because of the MICR-line error would cause a loss. For example, a document with a MICR-line error only in the amount field or the account number field likely would go through the entire collection process but may be charged for the wrong amount or to the wrong account, respectively. Because purported substitute checks would not be subject to the Check 21 Act, a person suffering such a loss would not have the Act's rights and protections regarding substitute checks. To fill this gap and protect persons who collect, pay, or otherwise receive a purported substitute check, § 229.51(d) of the proposed rule provided that a purported substitute check would be subject to the warranty, indemnity, and consumer-related provisions of the Check 21 Act and subpart D.

Several commenters generally supported the concept of the purported substitute check, although some of these commenters suggested specific revisions to this provision or clarifications about its application. A few commenters that supported the provision requested that it be expanded to apply to a document that failed any of the four substitute check requirements. One commenter neither supported nor opposed the purported substitute check concept but requested clarification about how a document would purport to be a substitute check.

The majority of commenters, however, suggested that the Board delete the purported substitute check provision. These commenters suggested that a document should be a substitute check and a legal equivalent if it contained any MICR-line error, thus obviating the purported substitute check provision.

The final rule leaves the scope of permissible MICR-line variations to ANS X9.100–140. The Board expects this standard to identify the circumstances under which a substitute check's MICR line may vary from the original check in order to facilitate processing of substitute checks. An item that satisfies all the requirements of

ANS X9.100–140 is a substitute check that is legally equivalent to the original check (provided all the other requirements for substitute checks and legal equivalency are met).

Regardless of how ANS X9.100–140 addresses permissible MICR-line variations and other substitute check requirements, there inevitably will be instances where a document intended to be a substitute check will fail one or more components of the substitute check definition and thus will not be a substitute check.

The Board notes that there are cases in the current check-processing environment where documents that are not checks or the legal equivalent thereof (for example, photocopies and image replacement documents) nonetheless go through the collection and return process and ultimately are paid, resulting in a charge to a customer's account. It is uncertain how often a bank attempting to create a substitute check instead will create a document with a MICR line that does not satisfy the substitute check definition. The Board therefore has removed the purported substitute check provision from the final rule. If the purported substitute check problem appears broad in scope, creates uncertainty for paying banks regarding whether to make payments, or is detrimental to drawers, the Board will consider addressing those problems by rule or order.

E. Section 229.52 Substitute Check Warranties

The Check 21 Act provides that any bank that transfers, presents, or returns a substitute check for consideration warrants that the substitute check meets the requirements for legal equivalence and that no depositary bank, drawee, drawer, or indorser will be asked to make a duplicative payment.

Section 229.52 of the proposed rule reorganized the statutory language and clarified that the responsibility for the warranties flows with the substitute check and with a paper or electronic representation of that substitute check. The proposed commentary also clarified that warranties associated with the first substitute check continue to flow if a second substitute check is created. These clarifications were intended to ensure that the warranty chain would continue from the first reconverting bank all the way through to the final recipient of a substitute check or representation thereof. The proposed commentary also clarified that a bank's responsibility for the warranties would run only to subsequent parties that received a substitute check or a paper or

electronic representation thereof, not to parties that handled only the original check or that handled the substitute check or representation prior to the warranting bank.

The final rule adopts the text of proposed § 229.52 without revision. However, the Board has revised the commentary to clarify further the issues identified in the previous paragraph and additional issues identified by commenters.

1. *Legal Equivalence Warranty.*

Several commenters expressed concern about a reconverting bank being held liable for breaching the legal equivalence warranty because of something that was beyond its control, for example if the drawer wrote payment information on the original check in a type of ink that did not survive the image capturing process well. One commenter suggested that the paying bank should bear the loss for breach of the legal equivalence warranty in such cases because it can control for ink type and the use of security features by agreements with its depositors. This commenter also suggested that the drawer in such cases should not be permitted to make an indemnity claim or expedited recredit claim if the legal equivalence defect was attributable to the drawer's action. Another commenter requested clarification about whether a bank would have an obligation not to convert a check that would not legibly survive the image capturing process.

The Check 21 Act contemplates that a bank can create a substitute check to represent any check as defined in § 229.2(k) and use that substitute check instead of the original check. However, the statute also attempts to place as little burden as possible on those that receive substitute checks, such as a drawer that receives paid checks or a paying bank that demands presentment of a paper check. Because the reconverting bank chose to use a substitute check instead of the original check, the Check 21 Act allocates liability to the reconverting bank for a substitute check that, at the time of its creation, did not meet the legal equivalence requirements. However, a reconverting bank may by agreement pass this liability back to the party that sent the electronic check image to it.

2. *Duplicative Payment Warranty.*

One commenter stated that the duplicative payment warranty should apply regardless of the order in which duplicative payment requests occur. The commentary to the final rule makes this point explicitly.

Several commenters acknowledged that the commentary to the proposed rule stated that a reconverting bank

would be liable for breach of the duplicative payment warranty even if a duplicative payment was caused by a fraud of which the bank was unaware. However, some of these commenters suggested that the reconverting bank should not be liable for a warranty breach under these circumstances. Responsibility under the Check 21 Act for the duplicative payment warranty does not depend upon the warranting bank's knowledge or fault, although a bank can further allocate such liability by agreement or under provisions of otherwise applicable check law. The final rule therefore contains a fraudulent duplicative payment example.

The Board's proposed rule did not directly address whether a payment made through an ACH debit, as opposed to a check payment made by electronic presentment, would be subject to the duplicative payment warranty. The Board noted that the language of the warranty, which states that a person will not be asked to pay a check it already has paid, could be read to exclude a payment made by ACH debit. The Board specifically requested comment on this issue.

Several commenters stated that an ACH debit should be covered under the duplicative payment warranty because recipients of such debits were not adequately protected by Regulation E and the NACHA rules. Approximately 60 commenters stated that the duplicative payment warranty should not apply to ACH debits because such debits are already adequately covered by existing laws and rules.

The statutory language indicates that the duplicative payment warranty applies to charges initiated by check, and ACH debits are not checks. The Board therefore believes that the best reading of the Check 21 Act is to exclude ACH debits from coverage under the Act's duplicative payment warranty. The Board notes that the U.C.C. applies to unauthorized check payments and the NACHA rules apply to unauthorized ACH debits. In addition, Regulation E applies to unauthorized ACH debits to consumer accounts.

F. Section 229.53 Substitute Check Indemnity

The Check 21 Act indemnity protects against losses that any recipient of a substitute check suffers due to receipt of a substitute check instead of an original check. The Board's proposed rule and commentary clarified that, like the Check 21 warranties, all banks that transfer a substitute check or a paper or electronic representation of a substitute check make the indemnity. This is to

ensure that, if an indemnity recipient makes a claim for a loss caused by receipt of a substitute check, that loss would be passed back to the first reconverting bank regardless of the number of times the item changed forms. The proposed rule and commentary also attempted to clarify that, unlike a warranty claim, which can be triggered by receipt of a substitute check or a representation of a substitute check, an indemnity claim is triggered in the first instance only by a loss that is due to receipt of a substitute check instead of the original check. The proposed commentary further clarified the scope of losses recoverable under the indemnity. The Board has adopted the regulatory text of the proposed indemnity section and the accompanying commentary with changes, discussed in the following paragraphs, designed to further clarify operation of that provision.

One commenter indicated that the Board should more clearly distinguish between the flow of responsibility for making the indemnity and the flow of an indemnity claim back up the chain of indemnifying banks. In particular, the commenter requested that the Board better articulate that an indemnity claim must be based on a loss due to any person's receipt of a substitute check. The proposed commentary noted that an indemnity claim must be "ultimately traceable" to the receipt of a substitute check, but another commenter objected to that language and preferred that the Board return to the statutory "due to" language. The commentary to the final rule addresses these concerns.

Several commenters requested clarification about the interaction between the substitute check indemnity and other law. Two commenters suggested clarification about the measure of damages under the indemnity section and the general liability provision (§ 229.56). The proposed commentary contained examples of the indemnity amount with and without a warranty breach, and the final rule further clarifies this distinction. The Board also has added a paragraph describing how production of the original check or a sufficient copy by the indemnifying bank will limit that bank's damages under § 229.53. Production of that item, however, would not absolve the indemnifying bank from warranty claims under any other law. In response to a comment, the Board has clarified that Regulation CC and the U.C.C. are sources of such other warranties.

Three commenters suggested that the Board establish a time limit for bringing an indemnity claim. The liability

provisions of the Check 21 Act, as implemented at § 229.56 of Regulation CC, already establish a one-year statute of limitations for claims under the Check 21 Act.

Several commenters indicated that the examples the Board provided in the commentary to § 229.53 to illustrate the application of the indemnity provision were useful, although some commenters requested that the Board include additional examples. Although the Board has clarified the existing examples, the final rule does not provide additional examples. If experience indicates that there are particular aspects of the indemnity that call for greater clarification, the Board may add examples.

G. Section 229.54 Expedited Recredit for Consumers

The Board's proposed rule reorganized the structure of the consumer expedited recredit provision and clarified how to calculate the time periods that applied for consumer and bank action. The proposed commentary provided a number of examples about how the expedited recredit provision would work in practice.

1. *General Comments.* Numerous commenters, including consumers and consumer groups, stated that the expedited recredit provision should apply even if the consumer was not provided a substitute check. These commenters argued that the Check 21 Act produces this result because the information a consumer must provide to make a claim does not include a statement that the consumer received a substitute check. These commenters also suggested that the legislative history indicated a congressional intent that the expedited recredit apply any time a substitute check was used to process a check. Several of these commenters further suggested that, if the Board retained the requirement that a consumer must receive a substitute check as a condition of the expedited recredit right, then provision of a substitute check or a paper or electronic representation of a substitute check should meet that requirement.²³

The requirement that a consumer must receive a substitute check to have an expedited recredit claim comes directly from section 7(a) of the Check

21 Act, which states that a consumer may make an expedited recredit claim if he or she can assert in good faith that, among other things, "the bank charged the consumer's account for a *substitute check that was provided to the consumer*" (emphasis added).²⁴ When the Check 21 Act gives rights to a person that received a paper or electronic representation of a substitute check, it explicitly so indicates. For example, section 5 states that the warranties are given to the listed persons "regardless of whether the warrantee receives the substitute check or another paper or electronic form of the substitute check or original check." The consumer expedited recredit provision contains no language to indicate that receipt of something other than a substitute check is meant to trigger the right. In addition, only those consumers who receive substitute checks are entitled to the consumer awareness disclosure that explains expedited recredit rights, which further demonstrates that the right applies only to recipients of substitute checks.

The expedited recredit procedure is intended to place consumers who receive substitute checks in the same position to the extent practicable as if they had received the original check. The right is not intended to apply to consumers who already have agreed not to receive paper checks. Giving consumers an expedited recredit right in the additional situations suggested by the commenters thus would exceed both the text and the underlying intent of the statute. The Board therefore has not expanded the scope of § 229.54.

Several commenters requested clarification about whether the expedited recredit right would apply to checks that are not drawn on a consumer account, such as travelers' checks, credit card checks, and checks used to access a home equity line of credit. The statute specifically states that a substitute check is subject to the expedited recredit right if the bank holding the consumer's account charged the account for that substitute check. The Act specifically defines the term account to be a deposit account. Therefore, a consumer generally would not have an expedited recredit right associated with a check that was not drawn on his or her deposit account. However, the consumer could have an expedited recredit right for such a check deposited into his or her account if the

check was returned to the consumer unpaid in the form of a substitute check for which the bank debited the consumer's account. A consumer who did not have an expedited recredit right for a substitute check that he or she wrote but that was not charged to his or her account nonetheless might have a substitute check warranty or indemnity claim or a U.C.C. claim with respect to that item. The Board has clarified these points in the commentary to § 229.54(a).

Several commenters objected to the portion of the proposed commentary to § 229.54 stating that any warranty claim, not just a claim for a substitute check warranty provided in § 229.52, could trigger an expedited recredit right. The Board notes that the returned check warranties in § 229.34(b) of Regulation CC would run to the drawer of the check. In addition, the Check 21 Act states that a consumer may use the expedited recredit procedure to recover for "a warranty claim" and does not limit such claims to the substitute check warranties. The final commentary therefore retains the concept that losses associated with any warranty breach are recoverable under § 229.54, although the Board has provided more detail about the additional warranties contemplated.

Several commenters suggested that, if a consumer requests an original check, then the bank should be required to provide either the original check or a legally equivalent substitute check. Such a requirement is beyond the scope of the Check 21 Act, which does not establish requirements for when an original check or substitute check must be given but rather establishes the circumstances under which a substitute check may be used as the legal equivalent of the original check. Such a requirement also would go beyond the scope of U.C.C. 4-406, which, as adopted in most states, does not require a bank to provide original checks to consumers or to retain original checks.²⁵ The Board therefore has not adopted the commenters' suggestion.

The Board also has clarified in the commentary that the amount a consumer may claim as a loss under the consumer expedited recredit section includes the amount of the improper charge as well as any resulting fees that the consumer believes were improper, up to the amount of the substitute check. The commentary provides examples about the amount a consumer could claim.

²³ Another commenter understood the rule to mean that the expedited recredit procedure would apply if a consumer received a substitute check that was returned unpaid to the consumer's account but was concerned that the introductory paragraph to the model consumer awareness disclosure (which focused on checks written by consumers) might obscure that point. The Board has amended the model notice to address this concern.

²⁴ Section 7(h) further provides that "a consumer who was provided a substitute check may make a claim for an expedited recredit under this section with regard to a transaction involving the substitute check whether or not the consumer is in possession of the substitute check" (emphasis added).

²⁵ However, State law in New York and Massachusetts requires banks to give their customers the option of receiving paid paper checks with periodic account statements.

2. *Time Period for Consumer Action.* The Check 21 Act states that the consumer must make a claim within 40 days of the later of two dates: either the date on which the relevant account statement was mailed (or delivered by other means to which the consumer agreed) or the date on which the problematic substitute check was made available to the consumer. The proposed rule combined these concepts by stating that the claim was due within 40 days of the date that the relevant account statement or substitute check was mailed or delivered. The accompanying commentary clarified that the term delivery includes making the account statement or substitute check available through various means agreed to by the consumer, including in-person delivery.

The Board received numerous comments expressing concerns about the events that should trigger the 40-day time period within which a consumer must make an expedited recredit claim and what a consumer must do to constitute timely action within that period. A few commenters suggested that the final rule's construction should parallel that of the statute.

The Board has retained the "mailed or delivered" language in the rule text because the Board believes this construction clarifies rather than changes the statute's meaning. The Board has amended the final commentary to clarify that delivery includes making the statement or check available at the bank for the customer's retrieval pursuant to the customer's request.

Several commenters suggested that the Board adjust the 40-day time period for consumer action to parallel Regulation E (which gives consumers a 60-day period to make a claim for a disputed electronic fund transfer) or the U.C.C. (which gives consumers a reasonable period to examine a bank statement for errors). These commenters were concerned that having three different yet somewhat related timing requirements for consumer action would be confusing. Some commenters also were concerned that a consumer might receive a substitute check that triggered the time period for making a claim well after the underlying transaction, which could compromise the bank's ability to make a timely interbank expedited recredit claim under § 229.55.

The 40-day period in the proposed rule comes directly from the statute, and the Board has retained it in the final rule. A bank concerned about differences between Regulation E and § 229.54 could choose to give a consumer a longer period than required

by § 229.54 to bring a substitute check claim.

Several commenters asked for further clarification about what constituted extenuating circumstances that would require a bank to extend the consumer's 40-day period for making a claim. The proposed rule paralleled the approach in Regulation E by stating the existence of the extenuating circumstances extension in the rule text but moving to the commentary the statutory examples of what might justify an extension. The Board is unaware of any problems in applying the Regulation E extension provision and does not expect problems applying the corresponding provision in § 229.54. The Board therefore is not further clarifying the extenuating circumstances provision at this time.

Several commenters requested further clarification about what action by the consumer would satisfy the requirement to "submit" a claim within the specified period. These commenters noted that some portions of the rule and commentary referred to a consumer's making the claim, while others appeared to focus on the bank's receipt of the claim. Other commenters requested further clarification about the interaction between the consumer's ability to make an oral claim and the bank's right to require a consumer to submit a claim in writing.

The Board has clarified in the final rule that a consumer must submit his or her claim such that the bank receives it within the 40-day time period (extended if necessary) described in the regulation. The final rule also clarifies that, if a consumer submits a claim orally and the bank requires a written claim, the bank must inform the consumer of the written claim requirement at that time and may require the consumer to submit that written claim such that the bank receives it within 10 business days of the oral claim. This time period parallels the corresponding period in Regulation E for written confirmation of oral claims. In such a case, the consumer's claim would be timely if the bank received the oral claim within the 40-day period and the written claim within the 10-day period. In addition, the final rule and commentary provide that if a consumer attempts to submit a claim in any form and does not provide all the information required to constitute a claim, the bank must inform the consumer that the claim is incomplete and identify what information is missing.

One commenter requested that the Board clarify that a consumer who fails to bring a timely expedited recredit claim under § 229.54 nonetheless might have claims under other law, such as a

warranty or indemnity claim under § 229.52 or § 229.53, respectively, or a claim under the U.C.C. The Board has made this clarification in the commentary.

3. *Form of Claim and Time Period for Bank Action on Consumer Claims.* The statute provides that a bank must act on a consumer expedited recredit claim within 10 business days after the business day on which the consumer submits the claim. The proposed rule changed the latter occurrence of business day to banking day to parallel other provisions of Regulation CC. The Board received numerous comments on this clarification, all but four of which supported the adjustment. The final rule retains the proposed rule's use of the term banking day. The final rule also clarifies that the 10-day period within which the bank must act on the consumer's claim does not begin until the bank receives the claim. The Board believes that it is appropriate to focus on the bank's receipt, rather than the date of the consumer's mailing or delivery to provide certainty to the bank about the time period within which it must take action.

The final rule retains, with some revisions, the proposed rule's provision stating that the time period for bank action is measured from the bank's receipt of the written claim if the bank requires a consumer to submit an initial oral claim in writing. The final rule and commentary also clarify, in response to a comment, that a bank that requires a claim to be in writing must state that requirement in the consumer awareness disclosure it provides under § 229.57 and always must inform a consumer who makes a claim orally of the requirement at the time of the oral claim.

4. *Bank Action on Consumer Claims.*

a. *Bank Action Generally.* The proposed rule reorganized and clarified the provisions of the Check 21 Act related to the bank's options for responding to consumer claims and the notices associated with each of those options. Commenters that addressed the Board's reorganization strongly supported it. The final rule therefore retains the proposed organization of the bank action and notice provisions, but with some specific revisions suggested by commenters.

b. *A Bank's Choices for Responding to a Consumer Claim.* Under the Act and final rule, a bank may grant or deny a consumer's claim or provisionally recredit a consumer's account pending further investigation. The bank may reverse a recredit if it later determines the claim was invalid. A bank must provide a specific notice for each of

these actions. In addition, a bank that denies a claim must demonstrate to the consumer why the claim is not valid and provide the original check or a sufficient copy. One commenter asked whether a bank must retain a copy of expedited recredit claims that it receives. The Check 21 Act does not contain a retention requirement, although other record retention laws and regulations to which the bank is subject might apply.

Regarding provisional recredits, one commenter requested that the Board clarify that the interest due on a provisional recredit would be interest only on the amount of the recredit, rather than on the entire amount claimed by the consumer if that amount is greater than the recredit. The Board agrees that this is the correct result under the rule and therefore has not revised the final rule or commentary to address this point.

A few commenters expressed concern that the Board had diminished the requirement that the bank "demonstrate to the consumer that the claim is not valid" because the proposed rule instead stated that the bank must explain to the consumer the basis for its denial. The Board did not intend to deviate from the statutory requirement but rather to describe more specifically how a bank would satisfy it. These commenters also suggested that the consumer, rather than the bank, is the person that should determine whether a copy provided with a denied claim was sufficient to determine that the claim was not valid. In response to these comments, the text of the final rule uses the statutory language, and the commentary provides more detail about how a bank would demonstrate to the consumer that a claim is not valid.

In describing the bank's ability to reverse a recredit on a later determination that a claim was not valid, the proposed rule clarified that the bank could reverse the basic amount of the recredit plus interest on that amount. All commenters that addressed this point supported allowing a bank to reverse associated interest, although some suggested that the Board further clarify that the interest to be reversed included both the interest component of the initial recredit and the interest that accrued on the entire recredited amount. The final rule and commentary make this clarification.

Several commenters expressed concern about the provision of the proposed rule allowing the bank to reverse a recredit, particularly the statement that the bank may reverse a

recredit "at any time."²⁶ The Board has removed the quoted language from the text of the final rule and clarified in the commentary that the time period for the bank's reversal is subject to the applicable statute of limitations.

5. *Delayed Availability.* In response to comments, the commentary to the final rule clarifies that the rule allows a bank to delay the availability of both the base amount of the recredit and any interest on that amount. The Board in response to comments also has clarified in the commentary that the new account and repeated overdraft exceptions in subpart D apply as described in the commentary to the corresponding exceptions in subpart B.

6. *Notice Requirements.* Several commenters suggested that a bank should not be required to notify a consumer of a recredit if the bank affirmatively determines that the consumer's claim is valid. Section 7(f)(2) requires a notice for all recredits, not just those that are made provisionally pending further investigation. The Board therefore has retained the requirement in § 229.54 that a bank always notify the consumer of a recredit.

Notices regarding expedited recredit claims are deemed to be given on the business day that they are mailed or otherwise delivered in a manner agreed to by the consumer. One commenter suggested that electronic delivery of the consumer expedited recredit notices should be subject to the E-Sign Act. The E-Sign Act applies to notices that other law requires to be in writing (rather than in electronic form) and requires a consumer to affirmatively consent to electronic delivery of a written notice after the bank provides a detailed notice concerning electronic delivery. The Check 21 Act specifically states that a bank may provide the expedited recredit notices through any means to which the consumer has agreed. The Board believes that because the Check 21 Act specifically addresses alternative means of providing written information required by that Act, the E-Sign Act does not apply. A bank therefore need not comply with E-Sign when providing materials electronically under the Check 21 Act, although a bank voluntarily may choose to do so.

²⁶ One commenter suggested that the Board clarify that a bank cannot use the recredit reversal provision as a blanket right of set off to recover amounts from the consumer that are unrelated to the recredit claim. The recredit reversal provision of the rule only allows a bank to reverse a previously-provided recredit and does not apply to other amounts that the consumer might owe the bank.

7. *Other Claims Not Affected.* One commenter questioned the need for § 229.54(f) of the proposed rule, which stated that providing a consumer expedited recredit under § 229.54 does not absolve a bank from liability under other law. This provision of the Board's proposed rule came directly from the statute. A consumer may recover only up to the amount of the substitute check under § 229.54, although the consumer's losses associated with the substitute check may exceed that amount. Paragraph (f) is intended to clarify that a consumer may be able to recover those additional losses under other provisions that allow for proximately-caused damages exceeding the amount of the check, such as the substitute check indemnity or U.C.C. 4-402. The Board has added a reference to the U.C.C. in the rule text and a paragraph in the commentary that explains the intent and application of § 229.54(f).

8. *Sufficiency of Commentary and Examples.* The Board specifically requested comment on whether additional commentary to § 229.54 was needed. Commenters' reactions to this request were mixed. Thirteen commenters requested more commentary. Some of these were general requests, while other commenters offered specific examples that they wanted the Board to include. By contrast, ten commenters argued that no additional examples were needed, and some of these commenters even suggested that the Board omit certain of the proposed examples.

The Board has retained the examples from the commentary to the proposed rule with some clarifying changes. The Board has not, however, added examples or commentary except as noted in the preceding paragraphs. The Board expects that use of the consumer expedited recredit provision will be relatively rare and that the commentary addresses the most likely questions that banks might have regarding practical application of that provision. The Board will consider adding or deleting commentary and examples if experience indicates that the level of detail in the commentary is inappropriate.

H. Section 229.55 Expedited Recredit Procedures for Banks

Several banks expressed concern that the interbank recredit right would not work well in practice and identified various reasons for that concern. For example, some commenters stated that a bank that received an interbank expedited recredit claim might not know within the 10-day period for acting on that claim whether it could produce an original check or sufficient

copy. Such a bank might seek to obtain the original check or sufficient copy by submitting its own interbank recredit claim, which also would be subject to a 10-day response time. One commenter requested that the Board identify which transaction gave rise to a bank's claim and thus started the clock for making an interbank expedited recredit claim. A commenter also requested that the Board specify a particular method for calculating interest on a claim.²⁷ Other commenters requested additional clarification about who would enforce the interbank recredit process. Still another commenter asked how a consumer's receipt of an extension to make a consumer expedited recredit claim would affect the timing requirements for the interbank recredit process.

The Board has amended the time periods in § 229.55(b)–(c) for making and responding to an interbank claim to parallel the Board's amendments to the corresponding provisions of the consumer expedited recredit section. In response to a comment, the final commentary also clarifies which transaction triggers the claimant bank's 120-day period for making a claim. Aside from those changes, the Board has adopted § 229.55 and the accompanying commentary as proposed. The interbank recredit section may be varied by agreement. If banks determine that particular provisions of § 229.55 are problematic, they may agree to modify those provisions by agreement as they deem appropriate.

I. Section 229.56 Liability

The Board has adopted the provisions of proposed § 229.56 with some minor changes suggested by commenters.

In response to a comment, § 229.56(a)(1)(i) now contains language that parallels § 229.53(b)(1)(ii) when describing that losses recoverable under subpart D are, in the absence of a warranty and indemnity claim, limited to the amount of the substitute check plus interest and expenses.

Several commenters expressed concern that the Board's proposed rule included the identity of the party to be

sued as an element of accrual of a cause of action under § 229.56. The Board included this clarification in the proposed rule to make the standard for accrual parallel to the standard for making a timely claim. The final rule therefore retains the proposed accrual language regarding the identity of the party to be sued.

Two commenters expressed concern or confusion about the interaction of § 229.54, which requires a consumer to bring an expedited recredit claim within 40 days of the delivery of the relevant account statement or substitute check, with the timing requirements of § 229.56. One commenter noted that § 229.56 generally states that a claim must be made within 30 days of accrual to be timely, whereas § 229.54 provides that a consumer has 40 days from delivery of the relevant account statement or substitute check to make a timely expedited recredit claim. This commenter suggested that a consumer be allowed this same 40-day period to make a timely claim for purposes of § 229.56. The Board notes that the statute and rule produce this result by providing that a timely consumer recredit claim under § 229.54 satisfies the timing requirement of § 229.56.

J. Section 229.57 and Appendix C Consumer Awareness and the Board's Model Language

1. *Consumer Awareness Disclosure in General.* The Board has amended the text of § 229.57 of the rule to parallel the statutory text more closely by providing that the consumer awareness disclosure required by subpart D must be brief.

The proposed rule required banks to provide the disclosure to consumers who received paid checks and consumers who received substitute checks on an occasional basis. Several commenters suggested that banks should be required to provide the disclosure to all consumers, not just those who receive substitute checks. Requiring notice for consumers who do not receive substitute checks would go beyond the requirements of the statute and could confuse consumers who receive a notice describing rights that they do not have. The Board therefore has not altered the basic scope of the consumer disclosure requirement. However, the final rule and commentary clarify that the reference to paid checks means paid original checks and paid substitute checks and does not refer to a statement that contains multiple check images per page.

The proposed rule stated that a bank responding to a request for a check by providing a substitute check must provide the disclosure in connection

with that substitute check "unless [the] bank already has provided the disclosure" to a consumer who receives paid checks. Some commenters understood the proposed rule to mean that a bank that already had provided the notice to a consumer who received paid checks with account statements would not be required to provide an additional notice when responding to a consumer's request for a check. Other commenters believed that notice upon provision of a substitute check always would be required.

The final rule provides that a bank always is required to provide the disclosure when responding to a request for a check by providing a substitute check. This approach more closely parallels the statutory language, which does not provide an exception to the requirement to provide a disclosure when providing a substitute check on an occasional basis. Moreover, the time that a consumer receives a substitute check in response to a particular request is likely when the disclosure will be most useful.

One commenter suggested that a bank should not be required to provide the substitute check disclosure in a separate mailing but rather should be allowed to provide the disclosure along with other account information. The rule would permit a bank to combine the substitute check disclosure with other information.

One commenter suggested that the consumer awareness disclosure should be required based on the consumer relationship rather than the account relationship, such that a bank need not provide an additional disclosure if an existing consumer customer opened a new account. The text of the final rule incorporates this interpretation. Another commenter suggested that the Board explain how the consumer awareness disclosure would apply in the context of joint account relationships. This commenter stated that notice to one account holder on a joint account should suffice as notice to each consumer on the account. The final rule includes language similar to that in § 229.15(c) regarding notice to joint account holders.

2. *Timing for a Disclosure Provided in Response to a Consumer's Request for a Check.* The statute requires a bank that provides a substitute check in response to a consumer's request for a check to provide the consumer awareness disclosure to the consumer "at the time of the request." There are some cases in which a bank would be able to provide the notice at the time of the consumer's request in a manner that is useful to the consumer, while other requests may

²⁷ Another commenter questioned why banks had 120 days to make a claim when the corresponding provision of § 229.54 gives consumers only 40 days. As the commentary to the proposed rule explained, the 120-day period for a bank to make a claim allows time for the statement to be delivered to the consumer and for the consumer to make a timely claim, plus it allows for multiple interbank claims with respect to the same substitute check. The Board thinks this explanation is more appropriate in the preamble, which discusses the basis for the rule's provisions, than in the commentary, which clarifies the application of those provisions. The Board accordingly has omitted this text from the commentary to the final rule.

present practical difficulties for banks. For example, a bank may not know at the time of the request what it will provide in response. Ultimately, the bank might provide something other than a substitute check to the consumer. If that bank had given the substitute check disclosure to the consumer at the time of the request, the consumer might be confused by receipt of a disclosure explaining rights that did not apply to the document (s)he received. Moreover, the consumer may make his or her request in such a manner (such as by telephone) that the bank is unable to provide the disclosure at the time of the request.

In light of the foregoing difficulties, the Board proposed two alternatives for when a bank must provide the disclosure to a consumer who requests a substitute check and requested comment on which alternative was preferable. The first alternative used the statutory language, while the second would have allowed the bank in all cases to provide the disclosure at the time it provided a substitute check in response to the consumer's request. Commenters overwhelmingly preferred the second alternative.

The final rule takes an approach that combines elements from the first and second alternatives. The final rule states that a bank must provide the disclosure to a consumer who requests a check or check copy at the time of the request if feasible and otherwise must provide the disclosure no later than the time at which the bank provides a substitute check in response to the request. The commentary provides examples of when it would not be feasible to provide the disclosure at the time of the request.

3. *Model Language for the Disclosure Required by § 229.57.* The Check 21 Act requires the Board to publish model language that banks could use to satisfy the consumer awareness disclosure requirement and that, when used appropriately, would be deemed to comply with that requirement. The Board requested comment on the model language that it proposed to include in existing appendix C.

The Board received numerous comments on the proposed model disclosure. Several commenters generally opined that the proposed language was adequate, although some of these commenters suggested that the model disclosure could be more concise. Numerous commenters expressed concern that the proposed language was so detailed that it would discourage consumers from reading the disclosure. These commenters suggested a specific, alternative model disclosure that was much shorter than the Board's

proposed disclosure. By contrast, five commenters suggested that the model disclosure should provide consumers with more detail about expedited recredit rights.²⁸ Many commenters made specific wording suggestions for the Board's consideration.

The final model disclosure, published as model 5A in appendix C, is shorter than the proposed model. In crafting this model disclosure, the Board has attempted to balance the requirement that the disclosure be brief and the need for the disclosure to contain enough information to enable a consumer to understand and, if necessary, exercise the expedited recredit right in § 229.54. The Board's revisions also reflect its consideration of the specific wording concerns expressed by commenters.

4. *Additional Model Language for Consumer Expedited Recredit Notices.* Although not required to do so by statute, the Board published for comment model notices that banks could use to respond to consumer expedited recredit claims under § 229.54(e). The Check 21 Act does not provide a safe harbor for appropriate use of these model notices, and the Board requested comment on whether having model language would be useful for banks in the absence of a safe harbor. Commenters strongly supported inclusion of the model notices, although many requested that the Board either give the language safe harbor status or specifically state that appropriate use of the models in the Board's view would constitute compliance with the Check 21 Act.

The Board has retained the model consumer expedited recredit notices in appendix C but has revised them. The proposed models focused on responding to claims for an improper charge to a consumer account, but the final models instead focus on whether the consumer's claim is or is not valid. These revisions will allow banks to use the model notices to respond to a consumer's claim regarding an improper charge to his or her account or regarding a warranty breach. Because the statute does not provide safe harbor status to these model notices, the Board has not indicated that appropriate use of the notice constitutes compliance with the rule. However, the Board has revised the language discussing the status of the model notices to indicate that the Board

²⁸ These commenters also suggested that the Board should require banks to respond accurately to consumer enquiries about how a particular check was processed. The Check 21 Act does not contain such a requirement. However, banks have a business incentive to respond appropriately to consumer enquiries on this and other topics.

has provided these models to help banks to comply with the rule.

K. Section 229.58 Mode of Delivery of Information Required by This Subpart

One commenter suggested that the Board should delete § 229.58, which contains the rule for electronic delivery of documents that applies to all of subpart D, and instead discuss electronic delivery of documents in each place in the rule where that concept is relevant. The Board has retained the proposed organization because it believes that discussing the issue of electronic delivery in one section and cross-referencing that section when appropriate is straightforward and efficient.

L. Section 229.60 Variation by Agreement

The Check 21 Act and final rule provide that the only provision that may be varied by agreement is the interbank recredit provision at section 8 of the Act and § 229.55 of the rule. The final rule provides commentary clarifying that this provision does not prevent a bank from taking action that is more favorable to the consumer than required by the Check 21 Act or the final rule.

II. Changes Unrelated to the Check 21 Act

In addition to the changes necessary to implement the Check 21 Act, the Board also proposed changes to a number of existing provisions in Regulation CC based on a general review of the rule. Commenters generally supported these proposed changes, although some expressed particular concerns as noted in the following paragraphs. With the exception of the changes discussed in the following paragraphs, the Board is adopting the proposed revisions to existing provisions in substantially the same form as in the Board's proposed rule.

A. Section 229.15 General Disclosure Requirements

The Board proposed to amend the commentary to § 229.15 to require that disclosures under subpart B be clear and conspicuous. The Board proposed this change in Regulation CC to parallel proposed changes to its consumer regulations.²⁹ However, the Board received numerous comments opposing the proposed changes to the consumer rules, and several commenters opposed inclusion of clear and conspicuous

²⁹ See 68 FR 68786, 68788, 68791, 68793, 68799 (all dated Dec. 10, 2003).

language in the Regulation CC commentary.

In response to concerns expressed regarding the proposed consumer regulations, the Board recently withdrew all the proposed amendments to the consumer rules.³⁰ In connection with that action, the Board determined that the goal of ensuring that consumers receive noticeable and understandable information should be achieved by developing proposals that focus on improving individual disclosures rather than the adoption of general definitions and standards applicable across all regulations.

The existing notice requirements in subparts B and C of Regulation CC have been in effect since 1988, and the Board is not aware that recipients of those notices have expressed concerns regarding the manner in which banks provide them. The Board therefore has determined that adding a clear and conspicuous requirement is unnecessary at this time and has not amended the commentary as proposed. The Board will reevaluate this issue in connection with its future periodic reviews of Regulation CC.

B. Section 229.30(c)(1) Paying Bank's Responsibility for Return of Checks

Section 229.30(c)(1) currently provides that a paying bank's midnight deadline for returning a check is extended if it uses a means of delivery that ordinarily would result in receipt by the receiving bank's next banking day. In response to a case holding that Reserve Banks have a 24-hour banking day for processing checks (see *Oak Brook v. Northern Trust*, 256 F.3d 638 (7th Cir., 2001)), the Board proposed to amend § 229.30(c)(1) to provide that the deadline would be extended if a paying bank used a means of delivery that ordinarily would result in the receiving bank's receipt of the check before the cutoff hour for its next processing cycle if sent to a returning bank or before its next banking day if sent to a depository bank.

The Board received several comments on this proposed change, most of which indicated that using the cutoff hour for the next processing cycle would be confusing and difficult to apply. These commenters noted that some banks have more than one such cutoff hour and that paying banks might not know the relevant times for each of the banks to which they return checks.

In response to these comments, the final rule provides that a paying bank must return a check "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 later set by the receiving bank under U.C.C. 4-108." This approach should provide the certainty of identifying a specific cutoff hour but also allow the receiving bank to set a cutoff hour of 2 p.m. or later or to close before 2 p.m.

C. Other Comments Concerning Non-Check 21-Related Changes

1. *Manner of Providing Subpart B notices.* Commenters generally supported the proposed changes to the commentary to §§ 229.13 and 229.15 that clarified the application of the E-Sign Act to notices and disclosures that subpart B requires to be in writing. However, one commenter expressed concern about existing language in the commentary stating that a notice is in a form that the consumer can keep if it can be "downloaded or printed." This commenter suggested that the standard be changed to "downloaded and printed." The Board is not aware of consumer problems associated with this requirement and notes that downloading information on a computer allows the recipient to access and use the information later. The Board also believes that it would be unusual for a bank to send an electronic notice such that it could not be printed. The Board therefore has retained the existing language.

Another commenter expressed concern about the requirement that notices and disclosures required by §§ 229.13(g), 229.16(c)(2), and 229.33(a)-(b) must include an account number, which the commenter interpreted to mean the entire account number. The commenter suggested that a bank should be permitted to redact all but the last four digits for information security purposes. The Board has amended §§ 229.13(g) and 229.16(c)(2) to allow for the proposed redaction. The Board has not amended § 229.33(a)-(b) because the notice required by that section is an interbank notice, and the receiving bank likely would need full account information for the notice to serve its intended purpose.

2. *Section 229.33 Notice of Nonpayment.* The Board received eleven comments concerning its request for comment on whether the time period for giving the notice of nonpayment should be reduced. Only two commenters opined that an adjustment was necessary. The Board therefore has left the time period unchanged. One commenter suggested that the Board amend this section to state that the bank must "provide or give" the notice, as

opposed to the "send or give" language proposed by the Board. This commenter was concerned that the Board's proposed language might be read to exclude providing notice by e-mail. The Board believes that the send or give language is sufficiently broad to allow notice in any form, and the proposed commentary explicitly stated that electronic notice would suffice if sent to the address specified by the recipient for that purpose. The Board therefore has adopted the language as proposed.

Another commenter suggested that the Board amend § 229.33 to provide that a bank could provide notice in the form of a substitute check or another paper or electronic representation of a check. The Board believes that the text of § 229.33(a), when combined with the revised commentary addressing the form of the nonpayment notice, already produces this result.

III. Responses to Specific Requests for Comment

In addition to proposing Check 21-related and non-Check 21-related changes, the Board also requested comment on several specific issues.

A. Remotely-Created Demand Drafts

The Board requested comment on whether Regulation CC should incorporate a U.C.C. warranty that would shift liability for an unauthorized remotely-created demand draft from the paying bank to the depository bank, although the Board did not propose specific regulatory language. Approximately 76 commenters addressed this issue, all but two of which strongly supported the general idea of covering liability for remotely-created demand drafts in Regulation CC. However, many commenters advocated changes from the uniform version of the warranty. For example, some commenters stated that the warranty should apply to all remotely-created demand drafts instead of only those drafts drawn on consumer accounts, and others suggested that the warranty should extend to all the draft's terms instead of the amount only. Many commenters encouraged the Board to propose specific language for comment in a separate rulemaking. The Board intends to issue a separate proposal regarding remotely-created demand drafts later this year.

B. Treatment of Industry Standards

The Board also received comments regarding whether it should identify specific industry standards in the rule text or the commentary. The vast majority of commenters on this issue preferred the Board's proposed

³⁰ See 69 FR 35541 (June 25, 2004).

approach of placing a general reference to industry standards in the text of the rule and identifying specific standards in the commentary. However, particularly with respect to substitute checks, many commenters preferred that the Board should indicate that a particular standard is exclusive.

In cases where the Board intends that an exclusive industry standard apply, such as the standards relating to MICR-line printing and substitute checks, the Board has identified a specific standard in the text of the final rule. The Board believes that this approach is more transparent for the reader and will better facilitate compliance with the rule.

C. Plain Language

The Board received four comments about whether the proposed rule and commentary were in plain language. Two of these commenters opined that the rule and commentary were in plain language, especially in light of the complexity of some provisions of the law. Another commenter suggested that the rule could be shortened if some elements were moved to an appendix but did not identify specific changes it would make. Another commenter requested that the rule better clarify the application or non-application of the Check 21 Act to non-consumer accounts. The Board has addressed this concern through its revisions to the account and consumer account definitions and through revisions to certain parts of the commentary.

Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3506; 5 CFR 1320 Appendix A.1), the Board reviewed the final rule under the authority delegated to the Board by the Office of Management and Budget (OMB). The final rule contains requirements subject to the PRA. The collection of information that is required by this final rule is found in 12 CFR 229.54, 229.55, and 229.57. This information is required to obtain a benefit for consumers and mandatory for depository institutions.

All depository institutions, of which there are approximately 19,280, potentially are affected by this collection of information, and thus are respondents for purposes of the PRA, because all depository institutions may respond to and make expedited recredit claims under §§ 229.54 and 229.55, respectively. In addition, all depository institutions that provide paid checks to consumer customers with periodic account statements or that otherwise provide substitute checks to consumer customers must provide the consumer

awareness notice in § 229.57. However, the extent to which this collection of information affects a particular depository institution will depend on whether and under what circumstances that depository institution provides substitute checks to consumers. For example, institutions that do not provide paid checks with account statements or provide substitute checks in response to consumers' occasional requests for paid checks will have significantly fewer consumer awareness disclosures and expedited recredit notices than will depository institutions that routinely provide paid checks to consumers.

The collection of information in this regulation is a new requirement for which the Federal Reserve has no direct method for estimating burden. The following average burden estimates for respondents regulated by the Federal Reserve therefore are based on the Federal Reserve's experience under similar, existing regulations with respect to the 1,244 state member banks and uninsured U.S. branches and agencies of foreign banks for which the Federal Reserve has administrative enforcement authority (collecting referred to in the following paragraphs as respondents regulated by the Federal Reserve) and for consumers who submit claims to those depository institutions. The following average burden estimates for respondents regulated by the Federal Reserve also represent an average across all such respondents and reflect variations between institutions based on their size, complexity, and practices. The Federal Reserve also has estimated the total annual burden associated with each notice both for respondents regulated by the Federal Reserve and for all affected depository institutions. The Federal Reserve estimates that half of all depository institutions affected by this rule do not provide paid checks with account statements or provide substitute checks and thus would have little or no burden for these requirements. The Federal Reserve has taken this fact into account by estimating total burden for all affected depository institutions on a weighted basis. The other banking agencies are responsible for estimating and reporting to OMB the total paperwork burden for the depository institutions for which they have administrative enforcement authority. They may, but are not required to, use the Federal Reserve's burden estimates.

Except as noted in the following paragraphs, the burden estimates for the final rule are the same as those the Federal Reserve identified for the proposed rule. One commenter expressed concern that the Federal

Reserve's proposed paperwork burden estimates in its proposed rule were too low. However, that commenter did not suggest specific revisions to those estimates.

The first notice, described in § 229.54(b)(2), is the information a consumer would provide when making an expedited recredit claim in writing. The Federal Reserve estimates that each respondent regulated by the Federal Reserve will receive, on average, 25 of these claims per year. The Federal Reserve estimates that it will take consumers, on average, 15 minutes to complete and send this claim. The Federal Reserve estimates that the total annual burden for consumers submitting claims to respondents regulated by the Federal Reserve is 7,775 hours. Using the Federal Reserve's methodology, the total annual burden for consumers submitting claims to all depository institutions would be approximately 67,300 hours.

The second notice, described in § 229.54(e), is required when a depository institution validates the consumer's claim, denies a consumer's recredit claim, or reverses a consumer's recredit claim. The Federal Reserve estimates that each respondent regulated by the Federal Reserve will send, on average, 35 of these notices per year. The Federal Reserve estimates that it will take each such respondent, on average, 15 minutes to prepare and distribute these notices (the Board has provided a model disclosure that depository institutions may use for this purpose). The estimated total annual burden for the respondents regulated by the Federal Reserve to respond to consumer claims is 10,885 hours. Using the Federal Reserve's, the total annual burden for all depository institutions would be approximately 94,200 hours.

The third notice, described in § 229.55 (b)(2), is required for each depository institution that is required to make a written claim against an indemnifying depository institution for a substitute check. The Federal Reserve estimates that each respondent regulated by the Federal Reserve will submit, on average, 15 of these claims per year. The Federal Reserve estimates that it will take each such respondent, on average, 15 minutes to complete and send each claim. The estimated total annual burden for respondents regulated by the Federal Reserve to submit interbank recredit claims is 4,665 hours. Using the Federal Reserve's methodology, the total annual burden for all depository institutions would be approximately 40,400 hours.

Finally, § 229.57 describes the requirements for depository institutions

to provide consumer awareness disclosures to consumers who receive paid checks with their periodic statements, who receive a substitute check in response to a request for a check, and who receive a returned check in the form of a substitute check. A model disclosure that depository institutions may use is provided in appendix C–5A.

The proposed rule contained an exception to the disclosure requirement for a depository institution that provided a substitute check on an occasional basis to a consumer who already had received the disclosure. The final rule, by contrast, requires that a depository institution always provide the disclosure when providing a substitute check on an occasional basis. The Federal Reserve believes that provision of a substitute check on an occasional basis in response to a consumer's request will be rare and thus does not expect that elimination of the proposed rule's exception will appreciably increase the number of disclosures. The final rule's paperwork burden estimate for notices provided on an occasional basis therefore is only slightly higher than that in the proposed rule.

The Federal Reserve estimates that each respondent regulated by the Federal Reserve will, on average, provide 510 disclosures per year (as compared with 500 disclosures per year in the proposed rule) and that, on average, it will take one minute to prepare and distribute the disclosure to each consumer. The one-minute estimate is a change from the proposed rule due to further analysis. The consumer awareness disclosures are standardized and machine-generated and do not substantively change from one individual account to another; thus, the average time for providing the disclosure to all consumers who are entitled to receive it should be small. The Federal Reserve estimated that the estimated total annual burden for respondents regulated by the Federal Reserve to provide the consumer awareness disclosure is 10,574 hours. Using the Federal Reserve's methodology, the total annual burden for all depository institutions would be approximately 91,500 hours.

The final rule would increase the total burden under Regulation CC for respondents regulated by the Federal Reserve and consumers submitting claims to those respondents by 33,899 hours, from 327,052 to 360,951. Using the methodology explained above, the final rule would increase total burden under Regulation CC for all depository

institutions by approximately 293,400 hours.

The Federal Reserve may not conduct or sponsor, and an organization is not required to respond to, this information collection unless it displays a currently valid OMB control number. The OMB control number is 7100–0235.

Regulatory Flexibility Act

The Board has prepared a final regulatory flexibility analysis as required by the Regulatory Flexibility Act (*see* 12 U.S.C. 604).

I. Need for and Objective of Rule

The Board is adopting this rule to implement the Check 21 Act. The Act requires the Board to publish a model disclosure that depository institutions may use to satisfy their consumer awareness disclosure requirements. The Act also authorizes the Board to adopt rules necessary to implement, prevent circumvention or evasion of, or facilitate compliance with the Act. The final rule adopts the text of the Check 21 Act with clarifying changes and commentary designed to aid depository institutions' understanding of and compliance with the Act. The final rule is incorporated into existing Regulation CC so that all the Board's generally applicable check collection requirements will be contained within one rule.

II. Summary of Issues Raised by Comments in Response to the Initial Regulatory Flexibility Analysis

The Board received two comments on its initial regulatory flexibility analysis. One commenter opined that the impact of the rule on small depository institutions should be proportional to that on larger depository institutions and should not be adverse to either. The other commenter expressed concern that the use of substitute checks could increase fraud and that small depository institutions would not have sufficient resources to develop fraud prevention techniques to respond to such increased risks. This commenter acknowledged that additional fraud risks associated with substitute checks could not yet be quantified but expressed concern that these risks would be burdensome. These comments did not provide specific information about the impact of the proposed rule on affected small depository institutions. The Board has not made regulatory changes based on the comments.

III. Description of Affected Small Entities

Under section 3 of the Small Business Act, as implemented at 13 CFR part 121, a bank is considered a "small entity" or

"small bank" if it has \$150 million or less in assets. Based on March 2004 call report data, the Board estimates that there are approximately 14,251 depository institutions with assets of \$150 million or less.

The Check 21 Act does not require any depository institution to create substitute checks or change its general check collection procedures, although after the Act's effective date any depository institution may receive a substitute check instead of an original check. The provisions of the Check 21 Act and the final rule potentially apply to all depository institutions regardless of their size. However, the extent to which any depository institution will be economically affected by the final rule depends on several variables, including how many substitute checks a depository institution handles and whether it creates those substitute checks. Even though all depository institutions that handle a substitute check for value make the substitute check warranties and indemnity and potentially are responsible for providing expedited recredit for a substitute check to a consumer or another depository institution, the final rule allocates most associated losses to the reconverting depository institution that first transferred, presented, or returned the substitute check for value. Thus, a depository institution's costs associated with substitute check-related problems primarily will depend on whether it chooses to create substitute checks. In addition, whether a depository institution must provide the consumer awareness disclosure contained in the final rule will depend on the depository institution's specific practices regarding providing checks to consumers.

Due to current uncertainty about each of the foregoing variables, aside from the burden estimates in the Paperwork Reduction Act section, the Board cannot at this time determine the number of small depository institutions that will be directly affected by the final rule or the rule's overall economic impact on small depository institutions.

IV. Recordkeeping, Reporting, and Compliance Requirements

The final rule does not contain recordkeeping or reporting requirements. However, a depository institution that provides paid checks to consumer customers with account statements or otherwise provides a substitute check to a consumer must provide consumer awareness disclosures. In addition, a depository institution that receives an expedited recredit claim from a consumer or other depository institution must comply with

the requirements of the relevant expedited recredit provision, including the requirements regarding timing for and notification of the depository institution's determination regarding the claim. The final rule allows depository institutions to vary by agreement the terms of the interbank recredit provision, but not the consumer expedited recredit provision.

V. Steps Taken To Minimize the Economic Impact on Small Entities

The requirements of the Check 21 Act that potentially affect small depository institutions are statutory. The Board has minimal flexibility to vary those requirements by regulation, but when possible it has indicated steps depository institutions may take to minimize risks under the Act. The substitute check warranties and indemnity are made as a matter of law when a depository institution transfers, presents, or returns a substitute check, but the final rule and commentary clarify in various places that depository institutions may further allocate liability amongst themselves by agreement. The maximum periods for acting on claims and the notices and other documentation that depository institutions must provide in connection with providing an expedited recredit to a consumer are specifically prescribed by the statute, but § 229.60 of the Board's final rule and the associated commentary clarify that a depository institution may choose to act in a manner more favorable to the consumer than the Act requires. Although the final rule also uses the statute's requirements regarding interbank expedited recredits, § 229.60 specifically notes that depository institutions themselves may vary any of those requirements by agreement. Finally, the statute specifically sets forth the events that trigger provision of and the timing requirements that apply to the consumer awareness disclosure, but § 229.57(b)(2)(i) gives depository institutions flexibility to provide disclosures for a substitute check given in response to specific request for a check at a later date when necessary.

Administrative Procedure Act

In accordance with 12 U.S.C. 553(d)(3), the Board for good cause finds that model disclosure C-5A in appendix C is effective immediately. The Check 21 Act requires the Board to publish model disclosure C-5A three months before the Act's effective date. A bank's appropriate use of model C-5A would constitute compliance with the consumer awareness disclosure requirements in section 12 of the Act

and § 229.57 of the final rule. The Board believes that delaying the effective date of model disclosure C-5A would undermine the Act's intent that banks be able to rely on the model language as soon as the Board publishes it.

12 CFR Chapter II

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 is amending 12 CFR part 229 to read as follows:

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

■ 1. The authority citation for part 229 is amended to read as follows:

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

§ 229.1 [Amended]

■ 2. In § 229.1, revise paragraph (a) and add a new paragraph (b)(4) to read as follows:

(a) *Authority and purpose.* This part is issued by the Board of Governors of the Federal Reserve System (Board) to implement the Expedited Funds Availability Act (12 U.S.C. 4001–4010) (the EFA Act) and the Check Clearing for the 21st Century Act (12 U.S.C. 5001–5018) (the Check 21 Act).

(b) *Organization.* * * *

(4) Subpart D of this part contains rules relating to substitute checks. These rules address the creation and legal status of substitute checks; the substitute check warranties and indemnity; expedited recredit procedures for resolving improper charges and warranty claims associated with substitute checks provided to consumers; and the disclosure and notices that banks must provide.

§ 229.2 [Amended]

■ 3. In § 229.2, revise the introductory sentence to read as follows:

As used in this part, and unless the context requires otherwise, the following terms have the meanings set forth in this section, and the terms not defined in this section have the meanings set forth in the Uniform Commercial Code:

* * * * *

■ 4. In § 229.2(a):

■ A. Redesignate existing paragraphs (1), (2), (3), (4), and (5) as paragraphs (a)(1)(i), (a)(1)(ii), (a)(1)(iii), (a)(1)(iv), and (a)(1)(v), respectively;

■ B. Designate paragraph (a) as paragraph (a)(1) and revise the first sentence of that paragraph;

■ C. Designate the undesignated paragraph as paragraph (2) and revise that paragraph; and

■ D. Add a new paragraph (3).

The revisions and addition read as follows:

(a) *Account.* (1) Except as provided in paragraphs (a)(2) and (a)(3) of this section, *account* means a deposit as defined in 12 CFR 204.2(a)(1)(i) that is a transaction account as described in 12 CFR 204.2(e). * * *

(2) For purposes of subpart B of this part and, in connection therewith, this subpart A, *account* does not include an account where the account holder is a bank, where the account holder is an office of an institution described in paragraphs (e)(1) through (e)(6) of this section or an office of a “foreign bank” as defined in section 1(b) of the International Banking Act (12 U.S.C. 3101) that is located outside the United States, or where the direct or indirect account holder is the Treasury of the United States.

(3) For purposes of subpart D of this part and, in connection therewith, this subpart A, *account* means any deposit, as defined in 12 CFR 204.2(a)(1)(i), at a bank, including a demand deposit or other transaction account and a savings deposit or other time deposit, as those terms are defined in 12 CFR 204.2.

* * * * *

■ 5. In § 229.2(e), remove the phrase “subpart C” from the last, undesignated paragraph and add the phrase “subparts C and D” in its place, and after the undesignated paragraph add a new paragraph to read as follows:

(e) * * *

Note: For purposes of subpart D of this part and, in connection therewith, this subpart A, *bank* also includes the Treasury of the United States or the United States Postal Service to the extent that the Treasury or the Postal Service acts as a paying bank.

* * * * *

■ 6. In § 229.2(k):

■ A. After paragraph (6), add a new paragraph (7) to read as follows:

(k) * * *

(7) The term check includes an original check and a substitute check.

■ B. Designate the undesignated paragraph with the word “Note” followed by a colon and remove the phrase “subpart C” from the last sentence of that paragraph and add the phrase “subparts C and D” in its place.

■ 7. In § 229.2(q), add the phrase “to a collecting bank for settlement or” between the words “basis” and “to.”

■ 8. In § 229.2(z), remove the phrase “subpart C” from the undesignated paragraph and add the phrase “subparts C and D” in its place, and after the undesignated paragraph add a new paragraph to read as follows:

* * * * *

Note: For purposes of subpart D of this part and, in connection therewith, this subpart A, *paying bank* also includes the Treasury of the United States or the United States Postal Service for a check that is payable by that entity and that is sent to that entity for payment or collection.

* * * * *

■ 9. In § 229.2(ff), add a new sentence after the first sentence to read as follows:

(ff) * * * For purposes of subpart D of this part and, in connection therewith, this subpart A, *state* also means Guam, American Samoa, the Trust Territory of the Pacific Islands, the Northern Mariana Islands, and any other territory of the United States.

* * * * *

■ 10. In § 229.2, revise paragraph (qq) to read as follows:

* * * * *

(qq) *Claimant bank* means a bank that submits a claim for a recredit for a substitute check to an indemnifying bank under § 229.55.

■ 11. In § 229.2, after paragraph (qq) add the following new paragraphs (rr) through (eee), to read as follows:

* * * * *

(rr) *Collecting bank* means any bank handling a check for forward collection, except the paying bank.

(ss) *Consumer* means a natural person who—

(1) With respect to a check handled for forward collection, draws the check on a consumer account; or

(2) With respect to a check handled for return, deposits the check into or cashes the check against a consumer account.

(tt) *Customer* means a person having an account with a bank.

(uu) *Indemnifying bank* means 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 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 (unless the Board by rule or order determines that different standards apply).

(ww) *Original check* means the first paper check issued with respect to a particular payment transaction.

(xx) *Paper or electronic representation of a substitute check* means any copy of or information related to a substitute check that a bank handles for forward collection or return, charges to a customer's account, or provides to a person as a record of a check payment made by the person.

(yy) *Person* means a natural person, corporation, unincorporated company, partnership, government unit or instrumentality, trust, or any other entity or organization.

(zz) *Reconverting bank* means—

(1) The bank that creates a substitute check; or

(2) With respect to a substitute check that was created by a person that is not a bank, the first bank that transfers, presents, or returns that substitute check or, in lieu thereof, the first paper or electronic representation of that substitute check.

(aaa) *Substitute check* means a paper reproduction of an original check that—

(1) Contains an image of the front and back of the original check;

(2) Bears a MICR line that, except as provided under ANS X9.100–140 (unless the Board by rule or order determines that a different standard applies), contains all the information appearing on the MICR line of the original check at the time that the original check was issued and any additional information that was encoded on the original check's MICR line before an image of the original check was captured;

(3) Conforms in paper stock, dimension, and otherwise with ANS X9.100–140 (unless the Board by rule or order determines that a different standard applies); and

(4) Is suitable for automated processing in the same manner as the original check.

(bbb) *Sufficient copy and copy*. (1) 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.

(2) A *copy* of an original check means any paper reproduction of an original check, including a paper printout of an electronic image of the original check, a photocopy of the original check, or a substitute check.

(ccc) *Transfer and consideration*. The terms *transfer* and *consideration* have the meanings set forth in the Uniform Commercial Code and in addition, for purposes of subpart D—

(1) The term *transfer* with respect to a substitute check or a paper or electronic representation of a substitute check means delivery of the substitute check or other representation of the substitute check by a bank to a person other than a bank; and

(2) A bank that transfers a substitute check or a paper or electronic representation of a substitute check directly to a person other than a bank has received *consideration* for the substitute check or other paper or electronic representation of the substitute check if it has charged, or has the right to charge, the person's account or otherwise has received value for the original check, a substitute check, or a representation of the original check or substitute check.

(ddd) *Truncate* means to remove an original check from the forward collection or return process and send to a recipient, in lieu of such original check, a substitute check or, by agreement, information relating to the original check (including data taken from the MICR line of the original check or an electronic image of the original check), whether with or without the subsequent delivery of the original check.

(eee) *Truncating bank* means—

(1) The bank that truncates the original check; or

(2) If a person other than a bank truncates the original check, the first bank that transfers, presents, or returns, in lieu of such original check, a substitute check or, by agreement with the recipient, information relating to the original check (including data taken from the MICR line of the original check or an electronic image of the original check), whether with or without the subsequent delivery of the original check.

§ 229.3 [Amended]

■ 12. In § 229.3, remove the phrase “the Act” from paragraphs (b)(1) and (c)(2)(ii) and add the phrase “the EFA Act” in its place.

§ 229.13 [Amended]

■ 13. Revise § 229.13(g)(1)(i)(A) to read as follows:

(g) * * *

(1) * * *

(i) * * *

(A) A number or code, which need not exceed four digits, that identifies the customer's account;

§ 229.16 [Amended]

■ 14. Revise § 229.16(c)(2)(i)(A) to read as follows:

- (c) * * *
- (2) * * *
- (i) * * *

(A) A number or code, which need not exceed four digits, that identifies the customer's account.

§ 229.20 [Amended]

■ 15. In § 229.20, remove the phrase “the Act” wherever it appears and add the phrase “the EFA Act” in its place.

§ 229.21 [Amended]

■ 16. In § 229.21(g)(2), remove the phrase “the Act” and add the phrase “the EFA Act” in its place.

§ 229.30 [Amended]

■ 17. In § 229.30:

■ A. In the undesignated paragraph after paragraph (a)(2)(iii), remove the next-to-last sentence and add two new sentences in its place; and

■ B. Revise paragraphs (c)(1) and (d).

The revisions and addition read as follows.

- (a) * * *
- (2) * * *
- (iii) * * *

* * * 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. * * *

* * * * *

- (c) * * *

(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 later set by the receiving bank under U.C.C. 4–108, for all deadlines other than those described in paragraph (c)(2) of this section; this deadline is extended further if a paying bank uses a highly expeditious means of transportation, even if this means of transportation would ordinarily result in delivery after the receiving bank's next cutoff hour or banking day referred to above; or

(d) *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 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.

* * * * *

§ 229.31 [Amended]

■ 18. In the undesignated paragraph after § 229.31(a)(2)(iii), remove the third sentence and add the following sentences in its place:

- (a) * * *
- (2) * * *
- (iii) * * *

* * * 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. * * *

* * * * *

§ 229.33 [Amended]

■ 19. In § 229.33:

■ A. In paragraph (b), remove the phrase “with question marks” from the last sentence of the undesignated paragraph; and

■ B. In paragraph (d), add the phrase “or give” between the words “send” and “notice.”

§ 229.34 [Amended]

■ 20. In § 229.34(c), add a new sentence at the end of paragraph (3) to read as follows:

- (c) * * *

(3) * * * For purposes of this paragraph, the information encoded after issue on the check or returned check includes any information placed in the MICR line of a substitute check that represents that check or returned check.

* * * * *

§ 229.35 [Amended]

■ 21. In § 229.35, revise paragraph (a) to read as follows:

(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 the indorsement standard set forth in appendix D of this part.

* * * * *

§ 229.38 [Amended]

■ 22. In § 229.38(d)(1), designate the last sentence with the word “Note” and revise it, and add a new sentence after the second sentence to read as follows:

(d) *Responsibility for certain aspects of checks—*(1) * * * 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.

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

* * * * *

■ 23. In § 229.38(f), remove the phrase “the Act” and add the phrase “the EFA Act” in its place.

■ 24. Add a new subpart D to read as follows:

Subpart D—Substitute Checks

Sec.

- 229.51 General provisions governing substitute checks.
- 229.52 Substitute check warranties.
- 229.53 Substitute check indemnity.
- 229.54 Expedited recredit for consumers.
- 229.55 Expedited recredit for banks.
- 229.56 Liability.
- 229.57 Consumer awareness.
- 229.58 Mode of delivery of information.
- 229.59 Relation to other law.
- 229.60 Variation by agreement.

Authority: 12 U.S.C. 5001–5018.

Subpart D—Substitute Checks**§ 229.51 General provisions governing substitute checks.**

(a) *Legal equivalence.* A substitute check for which a bank has provided the warranties described in § 229.52 is the legal equivalent of an original check for all persons and all purposes, including any provision of federal or state law, if the substitute check—

(1) Accurately represents all of the information on the front and back of the original check as of the time the original check was truncated; and

(2) Bears the legend, “This is a legal copy of your check. You can use it the same way you would use the original check.”

(b) *Reconverting bank duties.* A bank shall ensure that a substitute check for which it is the reconverting bank—

(1) Bears all indorsements applied by parties that previously handled the

check in any form (including the original check, a substitute check, or another paper or electronic representation of such original check or substitute check) for forward collection or return;

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

(3) Identifies the bank that truncated the original check, in accordance with ANS X9.100–140 and appendix D of this part.

(c) *Applicable law.* A substitute check that is the legal equivalent of an original check under paragraph (a) of this section shall be subject to any provision, including any provision relating to the protection of customers, of this part, the U.C.C., and any other applicable federal or state law as if such substitute check were the original check, to the extent such provision of law is not inconsistent with the Check 21 Act or this subpart.

§ 229.52 Substitute check warranties.

(a) *Content and provision of substitute check warranties.* 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—

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

(2) 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.

(b) *Warranty recipients.* A bank makes the warranties described in paragraph (a) of this section to the person to which the bank transfers, presents, or returns the substitute check or a paper or electronic representation of such substitute check and to any subsequent recipient, which could include a collecting or returning bank, the depository bank, the drawer, the drawee, the payee, the depositor, and any indorser. These parties receive the warranties regardless of whether they received the substitute check or a paper or electronic representation of a substitute check.

§ 229.53 Substitute check indemnity.

(a) *Scope of indemnity.* 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.

(b) *Indemnity amount—(1) In general.* Unless otherwise indicated by paragraph (b)(2) or (b)(3) of this section, the amount of the indemnity under paragraph (a) of this section is as follows:

(i) If the loss resulted from a breach of a substitute check warranty provided under § 229.52, the amount of the indemnity shall be the amount of any loss (including interest, costs, reasonable attorney's fees, and other expenses of representation) proximately caused by the warranty breach.

(ii) If the loss did not result from a breach of a substitute check warranty provided under § 229.52, the amount of the indemnity shall be the sum of—

(A) The amount of the loss, up to the amount of the substitute check; and

(B) Interest and expenses (including costs and reasonable attorney's fees and other expenses of representation) related to the substitute check.

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

(ii) Nothing in this paragraph (b)(2) reduces the rights of a consumer or any other person under the U.C.C. or other applicable provision of state or federal law.

(3) *Effect of producing the original check or a sufficient copy—*

(i) If an indemnifying bank produces the original check or a sufficient copy, the indemnifying bank shall—

(A) Be liable under this section only for losses that are incurred up to the time that the bank provides that original check or sufficient copy to the indemnified person; and

(B) Have a right to the return of any funds it has paid under this section in excess of those losses.

(ii) The production by the indemnifying bank of the original check or a sufficient copy under paragraph (b)(3)(i) of this section shall not absolve the indemnifying bank from any

liability under any warranty that the bank has provided under § 229.52 or other applicable law.

(c) *Subrogation of rights—(1) In general.* An indemnifying bank shall be subrogated to the rights of the person that it indemnifies to the extent of the indemnity it has provided and may attempt to recover from another person based on a warranty or other claim.

(2) *Duty of indemnified person for subrogated claims.* Each indemnified person shall have a duty to comply with all reasonable requests for assistance from an indemnifying bank in connection with any claim the indemnifying bank brings against a warrantor or other person related to a check that forms the basis for the indemnification.

§ 229.54 Expedited recredit for consumers.

(a) *Circumstances giving rise to a claim.* A consumer may make a claim under this section for a recredit with respect to a substitute check if the consumer asserts in good faith that—

(1) The bank holding the consumer's account charged that account for a substitute check that was provided to the consumer (although the consumer need not be in possession of that substitute check at the time he or she submits a claim);

(2) The substitute check was not properly charged to the consumer account or the consumer has a warranty claim with respect to the substitute check;

(3) The consumer suffered a resulting loss; and

(4) Production of the original check or a sufficient copy is necessary to determine whether or not the substitute check in fact was improperly charged or whether the consumer's warranty claim is valid.

(b) *Procedures for making claims.* A consumer shall make his or her claim for a recredit under this section with the bank that holds the consumer's account in accordance with the timing, content, and form requirements of this section.

(1) *Timing of claim.* (i) The consumer shall submit his or her claim such that the bank receives the claim by the end of the 40th calendar day after the later of the calendar day on which the bank mailed or delivered, by a means agreed to by the consumer—

(A) The periodic account statement that contains information concerning the transaction giving rise to the claim; or

(B) The substitute check giving rise to the claim.

(ii) If the consumer cannot submit his or her claim by the time specified in paragraph (b)(1)(i) of this section

because of extenuating circumstances, the bank shall extend the 40-calendar-day period by an additional reasonable amount of time.

(iii) If a consumer makes a claim orally and the bank requires the claim to be in writing, the consumer's claim is timely if the oral claim was received within the time described in paragraphs (b)(1)(i)–(ii) of this section and the written claim was received within the time described in paragraph (b)(3)(ii) of this section.

(2) *Content of claim.* (i) The consumer's claim shall include the following information:

(A) A description of the consumer's claim, including the reason why the consumer believes his or her account was improperly charged for the substitute check or the nature of his or her warranty claim with respect to such check;

(B) A statement that the consumer suffered a loss and an estimate of the amount of that loss;

(C) The reason why production of the original check or a sufficient copy is necessary to determine whether or not the charge to the consumer's account was proper or the consumer's warranty claim is valid; and

(D) Sufficient information to allow the bank to identify the substitute check and investigate the claim.

(ii) If a consumer attempts to make a claim but fails to provide all the information in paragraph (b)(2)(i) of this section that is required to constitute a claim, the bank shall inform the consumer that the claim is not complete and identify the information that is missing.

(3) *Form and submission of claim; computation of time for bank action.* The bank holding the account that is the subject of the consumer's claim may, in its discretion, require the consumer to submit the information required by this section in writing. A bank that requires a written submission—

(i) May permit the consumer to submit the written claim electronically;

(ii) Shall inform a consumer who submits a claim orally of the written claim requirement at the time of the oral claim and may require such consumer to submit the written claim such that the bank receives the written claim by the 10th business day after the banking day on which the bank received the oral claim; and

(iii) Shall compute the time periods for acting on the consumer's claim described in paragraph (c) of this section from the date on which the bank received the written claim.

(c) *Action on claims.* A bank that receives a claim that meets the

requirements of paragraph (b) of this section shall act as follows:

(1) *Valid consumer claim.* If the bank determines that the consumer's claim is valid, the bank shall—

(i) Recredit the consumer's account for the amount of the consumer's loss, up to the amount of the substitute check, plus interest if the account is an interest-bearing account, no later than the end of the business day after the banking day on which the bank makes that determination; and

(ii) Send to the consumer the notice required by paragraph (e)(1) of this section.

(2) *Invalid consumer claim.* If a bank determines that the consumer's claim is not valid, the bank shall send to the consumer the notice described in paragraph (e)(2) of this section.

(3) *Recredit pending investigation.* If the bank has not taken an action described in paragraph (c)(1) or (c)(2) of this section before the end of the 10th business day after the banking day on which the bank received the claim, the bank shall—

(i) By the end of that business day—

(A) Recredit the consumer's account for the amount of the consumer's loss, up to the lesser of the amount of the substitute check or \$2,500, plus interest on that amount if the account is an interest-bearing account; and

(B) Send to the consumer the notice required by paragraph (e)(1) of this section; and

(ii) Recredit the consumer's account for the remaining amount of the consumer's loss, if any, up to the amount of the substitute check, plus interest if the account is an interest-bearing account, no later than the end of the 45th calendar day after the banking day on which the bank received the claim and send to the consumer the notice required by paragraph (e)(1) of this section, unless the bank prior to that time has determined that the consumer's claim is or is not valid in accordance with paragraph (c)(1) or (c)(2) of this section.

(4) *Reversal of recredit.* A bank may reverse a recredit that it has made to a consumer account under paragraph (c)(1) or (c)(3) of this section, plus interest that the bank has paid, if any, on that amount, if the bank—

(i) Determines that the consumer's claim was not valid; and

(ii) Notifies the consumer in accordance with paragraph (e)(3) of this section.

(d) *Availability of recredit.*—(1) *Next-day availability.* Except as provided in paragraph (d)(2) of this section, a bank shall make any amount that it recredits to a consumer account under this

section available for withdrawal no later than the start of the business day after the banking day on which the bank provides the recredit.

(2) *Safeguard exceptions.* A bank may delay availability to a consumer of a recredit provided under paragraph (c)(3)(i) of this section until the start of the earlier of the business day after the banking day on which the bank determines the consumer's claim is valid or the 45th calendar day after the banking day on which the bank received the oral or written claim, as required by paragraph (b) of this section, if—

(i) The consumer submits the claim during the 30-calendar-day period beginning on the banking day on which the consumer account was established;

(ii) Without regard to the charge that gave rise to the recredit claim—

(A) On six or more business days during the six-month period ending on the calendar day on which the consumer submitted the claim, the balance in the consumer account was negative or would have become negative if checks or other charges to the account had been paid; or

(B) On two or more business days during such six-month period, the balance in the consumer account was negative or would have become negative in the amount of \$5,000 or more if checks or other charges to the account had been paid; or

(iii) The bank has reasonable cause to believe that the claim is fraudulent, based on facts that would cause a well-grounded belief in the mind of a reasonable person that the claim is fraudulent. The fact that the check in question or the consumer is of a particular class may not be the basis for invoking this exception.

(3) *Overdraft fees.* A bank that delays availability as permitted in paragraph (d)(2) of this section may not impose an overdraft fee with respect to drafts drawn by the consumer on such recredited funds until the fifth calendar day after the calendar day on which the bank sent the notice required by paragraph (e)(1) of this section.

(e) *Notices relating to consumer expedited recredit claims.*—(1) *Notice of recredit.* A bank that recredits a consumer account under paragraph (c) of this section shall send notice to the consumer of the recredit no later than the business day after the banking day on which the bank recredits the consumer account. This notice shall describe—

(i) The amount of the recredit; and

(ii) The date on which the recredited funds will be available for withdrawal.

(2) *Notice that the consumer's claim is not valid.* If a bank determines that a

substitute check for which a consumer made a claim under this section was in fact properly charged to the consumer account or that the consumer's warranty claim for that substitute check was not valid, the bank shall send notice to the consumer no later than the business day after the banking day on which the bank makes that determination. This notice shall—

(i) Include the original check or a sufficient copy, except as provided in § 229.58;

(ii) Demonstrate to the consumer that the substitute check was properly charged or the consumer's warranty claim is not valid; and

(iii) Include the information or documents (in addition to the original check or sufficient copy), if any, on which the bank relied in making its determination or a statement that the consumer may request copies of such information or documents.

(3) *Notice of a reversal of recredit.* A bank that reverses an amount it previously recredited to a consumer account shall send notice to the consumer no later than the business day after the banking day on which the bank made the reversal. This notice shall include the information listed in paragraph (e)(2) of this section and also describe—

(i) The amount of the reversal, including both the amount of the recredit (including the interest component, if any) and the amount of interest paid on the recredited amount, if any, being reversed; and

(ii) The date on which the bank made the reversal.

(f) *Other claims not affected.* Providing a recredit in accordance with this section shall not absolve the bank from liability for a claim made under any other provision of law, such as a claim for wrongful dishonor of a check under the U.C.C., or from liability for additional damages, such as damages under § 229.53 or § 229.56 of this subpart or U.C.C. 4–402.

§ 229.55 Expedited recredit for banks.

(a) *Circumstances giving rise to a claim.* A bank that has an indemnity claim under § 229.53 with respect to a substitute check may make an expedited recredit claim against an indemnifying bank if—

(1) The claimant bank or a bank that the claimant bank has indemnified—

(i) Has received a claim for expedited recredit from a consumer under § 229.54; or

(ii) Would have been subject to such a claim if the consumer account had been charged for the substitute check;

(2) The claimant bank is obligated to provide an expedited recredit with respect to such substitute check under § 229.54 or otherwise has suffered a resulting loss; and

(3) The production of the original check or a sufficient copy is necessary to determine the validity of the charge to the consumer account or the validity of any warranty claim connected with such substitute check.

(b) *Procedures for making claims.* A claimant bank shall send its claim to the indemnifying bank, subject to the timing, content, and form requirements of this section.

(1) *Timing of claim.* The claimant bank shall submit its claim such that the indemnifying bank receives the claim by the end of the 120th calendar day after the date of the transaction that gave rise to the claim.

(2) *Content of claim.* The claimant bank's claim shall include the following information—

(i) A description of the consumer's claim or the warranty claim related to the substitute check, including why the bank believes that the substitute check may not be properly charged to the consumer account;

(ii) A statement that the claimant bank is obligated to recredit a consumer account under § 229.54 or otherwise has suffered a loss and an estimate of the amount of that recredit or loss, including interest if applicable;

(iii) The reason why production of the original check or a sufficient copy is necessary to determine the validity of the charge to the consumer account or the warranty claim; and

(iv) Sufficient information to allow the indemnifying bank to identify the substitute check and investigate the claim.

(3) *Requirements relating to copies of substitute checks.* If the information submitted by a claimant bank under paragraph (b)(2) of this section includes a copy of any substitute check, the claimant bank shall take reasonable steps to ensure that the copy cannot be mistaken for the legal equivalent of the check under § 229.51(a) or sent or handled by any bank, including the indemnifying bank, for forward collection or return.

(4) *Form and submission of claim; computation of time.* The indemnifying bank may, in its discretion, require the claimant bank to submit the information required by this section in writing, including a copy of the paper or electronic claim submitted by the consumer, if any. An indemnifying bank that requires a written submission—

(i) May permit the claimant bank to submit the written claim electronically;

(ii) Shall inform a claimant bank that submits a claim orally of the written claim requirement at the time of the oral claim; and

(iii) Shall compute the 10-day time period for acting on the claim described in paragraph (c) of this section from the date on which the bank received the written claim.

(c) *Action on claims.* No later than the 10th business day after the banking day on which the indemnifying bank receives a claim that meets the requirements of paragraph (b) of this section, the indemnifying bank shall—

(1) Recredit the claimant bank for the amount of the claim, up to the amount of the substitute check, plus interest if applicable;

(2) Provide to the claimant bank the original check or a sufficient copy; or

(3) Provide information to the claimant bank regarding why the indemnifying bank is not obligated to comply with paragraph (c)(1) or (c)(2) of this section.

(d) *Recredit does not abrogate other liabilities.* Providing a recredit to a claimant bank under this section does not absolve the indemnifying bank from liability for claims brought under any other law or from additional damages under § 229.53 or § 229.56.

(e) *Indemnifying bank's right to a refund.* (1) If a claimant bank reverses a recredit it previously made to a consumer account under § 229.54 or otherwise receives reimbursement for a substitute check that formed the basis of its claim under this section, the claimant bank shall provide a refund promptly to any indemnifying bank that previously advanced funds to the claimant bank. The amount of the refund to the indemnifying bank shall be the amount of the reversal or reimbursement obtained by the claimant bank, up to the amount previously advanced by the indemnifying bank.

(2) If the indemnifying bank provides the claimant bank with the original check or a sufficient copy under paragraph (c)(2) of this section, § 229.53(b)(3) governs the indemnifying bank's entitlement to repayment of any amount provided to the claimant bank that exceeds the amount of losses the claimant bank incurred up to that time.

§ 229.56 Liability.

(a) *Measure of damages—*(1) *In general.* Except as provided in paragraph (a)(2) or (a)(3) of this section or § 229.53, any person that breaches a warranty described in § 229.52 or fails to comply with any requirement of this subpart with respect to any other person shall be liable to that person for an amount equal to the sum of—

(i) The amount of the loss suffered by the person as a result of the breach or failure, up to the amount of the substitute check; and

(ii) Interest and expenses (including costs and reasonable attorney's fees and other expenses of representation) related to the substitute check.

(2) *Offset of recredits.* The amount of damages a person receives under paragraph (a)(1) of this section shall be reduced by any amount that the person receives and retains as a recredit under § 229.54 or § 229.55.

(3) *Comparative negligence.* (i) If a person incurs damages that resulted in whole or in part from that person's negligence or failure to act in good faith, then the amount of any damages due to that person under paragraph (a)(1) of this section shall be reduced in proportion to the amount of negligence or bad faith attributable to that person.

(ii) Nothing in this paragraph (a)(3) reduces the rights of a consumer or any other person under the U.C.C. or other applicable provision of federal or state law.

(b) *Timeliness of action.* Delay by a bank beyond any time limits prescribed or permitted by this subpart is excused if the delay is caused by interruption of communication or computer facilities, suspension of payments by another bank, war, emergency conditions, failure of equipment, or other circumstances beyond the control of the bank and if the bank uses such diligence as the circumstances require.

(c) *Jurisdiction.* A person may bring an action to enforce a claim under this subpart in any United States district court or in any other court of competent jurisdiction. Such claim shall be brought within one year of the date on which the person's cause of action accrues. For purposes of this paragraph, a cause of action accrues as of the date on which the injured person first learns, or by which such person reasonably should have learned, of the facts and circumstances giving rise to the cause of action, including the identity of the warranting or indemnifying bank against which the action is brought.

(d) *Notice of claims.* Except as otherwise provided in this paragraph (d), unless a person gives notice of a claim under this section to the warranting or indemnifying bank within 30 calendar days after the person has reason to know of both the claim and the identity of the warranting or indemnifying bank, the warranting or indemnifying bank is discharged from liability in an action to enforce a claim under this subpart to the extent of any loss caused by the delay in giving notice of the claim. A timely recredit claim by

a consumer under § 229.54 constitutes timely notice under this paragraph.

§ 229.57 Consumer awareness.

(a) *General disclosure requirement and content.* Each bank shall provide, in accordance with paragraph (b) of this section, a brief disclosure to each of its consumer customers that describes—

(1) That a substitute check is the legal equivalent of an original check; and

(2) The consumer recredit rights that apply when a consumer in good faith believes that a substitute check was not properly charged to his or her account.

(b) *Distribution—(1) Disclosure to consumers who receive paid checks with periodic account statements.* A bank shall provide the disclosure described in paragraph (a) of this section to a consumer customer who receives paid original checks or paid substitute checks with his or her periodic account statement—

(i) No later than the first regularly scheduled communication with the consumer after October 28, 2004, for each consumer who is a customer of the bank on that date; and

(ii) At the time the customer relationship is initiated, for each customer relationship established after October 28, 2004.

(2) *Disclosure to consumers who receive substitute checks on an occasional basis.*

(i) The bank shall provide the disclosure described in paragraph (a) of this section to a consumer customer of the bank who requests an original check or a copy of a check and receives a substitute check. If feasible, the bank shall provide this disclosure at the time of the consumer's request; otherwise, the bank shall provide this disclosure no later than the time at which the bank provides a substitute check in response to the consumer's request.

(ii) The bank shall provide the disclosure described in paragraph (a) of this section to a consumer customer of the bank who receives a returned substitute check, at the time the bank provides such substitute check.

(3) *Multiple account holders.* A bank need not give separate disclosures to each customer on a jointly held account.

§ 229.58 Mode of delivery of information.

A bank may deliver any notice or other information that it is required to provide under this subpart by United States mail or by any other means through which the recipient has agreed to receive account information. If a bank is required to provide an original check or a sufficient copy, the bank instead may provide an electronic image of the original check or sufficient copy if the

recipient has agreed to receive that information electronically.

§ 229.59 Relation to other law.

The Check 21 Act and this subpart supersede any provision of federal or state law, including the Uniform Commercial Code, that is inconsistent with the Check 21 Act or this subpart, but only to the extent of the inconsistency.

§ 229.60 Variation by agreement.

Any provision of § 229.55 may be varied by agreement of the banks involved. No other provision of this subpart may be varied by agreement by any person or persons.

25. In appendix C, revise the title and introductory paragraph and amend the table of contents by adding the new entries to read as follows:

Appendix C to Part 229—Model Availability Policy Disclosures, Clauses, and Notices; Model Substitute Check Policy Disclosure and Notices

This appendix contains model availability policy and substitute check policy disclosures, clauses, and notices to facilitate compliance with the disclosure and notice requirements of Regulation CC (12 CFR part 229). Although use of these models is not required, banks using them properly (with the exception of models C-22 through C-25) to make disclosures required by Regulation CC are deemed to be in compliance.

Model Disclosures

*	*	*	*	*
C-5A	Substitute Check Policy Disclosure			
*	*	*	*	*

Model Notices

*	*	*	*	*
C-22	Expedited Recredit Claim, Valid Claim Refund Notice			
C-23	Expedited Recredit Claim, Provisional Refund Notice			
C-24	Expedited Recredit Claim, Denial Notice			
C-25	Expedited Recredit Claim, Reversal Notice			

*	*	*	*	*
---	---	---	---	---

■ 26. In appendix C, after model C-5 add the following new model C-5A to read as follows:

*	*	*	*	*
---	---	---	---	---

C-5A—Substitute Check Policy Disclosure Substitute Checks and Your Rights— [Important Information About Your Checking Account]

Substitute Checks and Your Rights

What Is a Substitute Check?

To make check processing faster, federal law permits banks to replace original checks with "substitute checks." These checks are similar in size to original checks with a slightly reduced image of the front and back of the original check. The front of a substitute

check states: "This is a legal copy of your check. You can use it the same way you would use the original check." You may use a substitute check as proof of payment just like the original check.

Some or all of the checks that you receive back from us may be substitute checks. This notice describes rights you have when you receive substitute checks from us. The rights in this notice do not apply to original checks or to electronic debits to your account. However, you have rights under other law with respect to those transactions.

What Are My Rights Regarding Substitute Checks?

In certain cases, federal law provides a special procedure that allows you to request a refund for losses you suffer if a substitute check is posted to your account (for example, if you think that we withdrew the wrong amount from your account or that we withdrew money from your account more than once for the same check). The losses you may attempt to recover under this procedure may include the amount that was withdrawn from your account and fees that were charged as a result of the withdrawal (for example, bounced check fees).

The amount of your refund under this procedure is limited to the amount of your loss or the amount of the substitute check, whichever is less. You also are entitled to interest on the amount of your refund if your account is an interest-bearing account. If your loss exceeds the amount of the substitute check, you may be able to recover additional amounts under other law.

If you use this procedure, you may receive up to *(amount, not lower than \$2,500)* of your refund (plus interest if your account earns interest) within *(number of days, not more than 10)* business days after we received your claim and the remainder of your refund (plus interest if your account earns interest) not later than *(number of days, not more than 45)* calendar days after we received your claim.

We may reverse the refund (including any interest on the refund) if we later are able to demonstrate that the substitute check was correctly posted to your account.

How Do I Make a Claim for a Refund?

If you believe that you have suffered a loss relating to a substitute check that you received and that was posted to your account, please contact us at *(contact information, for example phone number, mailing address, e-mail address)*. You must contact us within *(number of days, not less than 40)* calendar days of the date that we mailed (or otherwise delivered by a means to which you agreed) the substitute check in question or the account statement showing that the substitute check was posted to your account, whichever is later. We will extend this time period if you were not able to make a timely claim because of extraordinary circumstances.

Your claim must include—

- A description of why you have suffered a loss (for example, you think the amount withdrawn was incorrect);
- An estimate of the amount of your loss;
- An explanation of why the substitute check you received is insufficient to confirm that you suffered a loss; and

- A copy of the substitute check [and/or] the following information to help us identify the substitute check: *(identifying information, for example the check number, the name of the person to whom you wrote the check, the amount of the check)*.

* * * * *

- 27. In appendix C, after model C-21 add new models C-22 through C-25 to read as follows:

* * * * *

C-2—Expedited Recredit Claim, Valid Claim Refund Notice

Notice of Valid Claim and Refund

We have determined that your substitute check claim is valid. We are refunding *(amount)* [of which *[(amount)* represents fees] [and] *[(amount)* represents accrued interest]] to your account. You may withdraw these funds as of *(date)*. [This refund is the amount in excess of the \$2,500 [plus interest] that we credited to your account on *(date)*.]

C-23—Expedited Recredit Claim, Provisional Refund Notice

Notice of Provisional Refund

In response to your substitute check claim, we are refunding *(amount)* [of which *[(amount)* represents fees] [and] *[(amount)* represents accrued interest]] to your account, while we complete our investigation of your claim. You may withdraw these funds as of *(date)*. [Unless we determine that your claim is not valid, we will credit the remaining amount of your refund to your account no later than the 45th calendar day after we received your claim.]

If, based on our investigation, we determine that your claim is not valid, we will reverse the refund by withdrawing the amount of the refund [plus interest that we have paid you on that amount] from your account. We will notify you within one day of any such reversal.

C-24—Expedited Recredit Claim, Denial Notice

Denial of Claim

Based on our review, we are denying your substitute check claim. As the enclosed *(type of document, for example original check or sufficient)* shows, *(describe reason for denial, for example the check was properly posted, the signature is authentic, there was no warranty breach)*.

[We have also enclosed a copy of the other information we used to make our decision.] [Upon your request, we will send you a copy of the other information that we used to make our decision.]

C-25—Expedited Recredit Claim, Reversal Notice

Reversal of Refund

In response to your substitute check claim, we provided a refund of *(amount)* by crediting your account on *(date(s))*. We now have determined that your substitute check claim was not valid. As the enclosed *(type of document, for example original check or sufficient copy)* shows, *(describe reason for reversal, for example the check was properly*

posted, the signature is authentic, there was no warranty breach). As a result, we have reversed the refund to your account [plus interest that we have paid you on that amount] by withdrawing *(amount)* from your account on *(date)*.

[We have also enclosed a copy of the other information we used to make our decision.] [Upon your request, we will send you a copy of the information we used to make our decision.]

- 28. In appendix D, revise the title and text to read as follows:

Appendix D to Part 229—Indorsement, Reconverting Bank Identification, and Truncating Bank Identification Standards

(1) The depository bank shall indorse an original check or substitute check according to the following specifications:

(i) The indorsement shall contain—

(A) The bank's nine-digit routing number, set off by an arrow at each end of the number and pointing toward the number, and, if the depository bank is a reconverting bank with respect to the check, an asterisk outside the arrow at each end of the routing number to identify the bank as a reconverting bank;

(B) The indorsement date; and

(C) The bank's name or location, if the depository bank applies the indorsement physically.

(ii) The indorsement also may contain—

(A) A branch identification;

(B) A trace or sequence number;

(C) A telephone number for receipt of notification of large-dollar returned checks; and

(D) Other information, provided that the inclusion of such information does not interfere with the readability of the indorsement.

(iii) The indorsement, if applied to an existing paper check, shall be placed on the back of the check so that the routing number is wholly contained in the area 3.0 inches from the leading edge of the check to 1.5 inches from the trailing edge of the check.³¹

(iv) When printing its depository bank indorsement (or a depository bank indorsement that previously was applied electronically) onto a substitute check at the time that the substitute check is created, a reconverting bank shall place the indorsement on the back of the check between 1.88 and 2.74 inches from the leading edge of the check. The reconverting bank may omit the depository bank's name and location from the indorsement.

(2) Each subsequent collecting bank or returning bank indorser shall protect the identifiability and legibility of the depository bank indorsement by indorsing an original check or substitute check according to the following specifications:

(i) The indorsement shall contain only—

(A) The bank's nine-digit routing number (without arrows) and, if the collecting bank

³¹ The leading edge is defined as the right side of the check looking at it from the front. The trailing edge is defined as the left side of the check looking at it from the front. See American National Standards Specifications for the Placement and Location of MICR Printing, X9.13.

or returning bank is a reconverting bank with respect to the check, an asterisk at each end of the number to identify the bank as a reconverting bank;

(B) The indorsement date, and

(C) An optional trace or sequence number.

(ii) The indorsement, if applied to an existing paper check, shall be placed on the back of the check from 0.0 inches to 3.0 inches from the leading edge of the check.

(iii) When printing its collecting bank or returning bank indorsement (or a collecting bank or returning bank indorsement that previously was applied electronically) onto a substitute check at the time that the substitute check is created, a reconverting bank shall place the indorsement on the back of the check between 0.25 and 2.50 inches from the trailing edge of the check.

(3) A reconverting bank shall comply with the following specifications when creating a substitute check:

(i) If it is a depository bank, collecting bank, or returning bank with respect to the substitute check, the reconverting bank shall place its own indorsement onto the back of the check as specified in this appendix.

(ii) A reconverting bank that also is the paying bank with respect to the substitute check shall so identify itself by placing on the back of the check, between 0.25 and 2.50 inches from the trailing edge of the check, its nine-digit routing number (without arrows) and an asterisk at each end of the number.

(iii) The reconverting bank shall place on the front of the check, outside the image of the original check, its nine-digit routing number (without arrows) and an asterisk at each end of the number, in accordance with ANS X9.100-140.

(iv) The reconverting bank shall place on the front of the check, outside the image of the original check, the truncating bank's nine-digit routing number (without arrows) and a bracket at each end of the number, in accordance with ANS X9.100-140.

(4) Any indorsement, reconverting bank identification, or truncating bank identification placed on an original check or substitute check shall be printed in black ink.

■ 29. In appendix E, paragraph II.B., revise the first, second, third, and last sentences of paragraph 1., revise paragraph 3., and add a new paragraph 4., to read as follows:

II. * * *

B. 229.2(a) Account

1. The EFA Act defines account to mean "a demand deposit account or similar transaction account at a depository institution." The regulation defines account, for purposes other than subpart D, in terms of the definition of "transaction account" in the Board's Regulation D (12 CFR part 204). This definition of account, however, excludes certain deposits, such as nondocumentary obligations (see 12 CFR 204.2(a)(1)(vii)), that are covered under the definition of "transaction account" in Regulation D. * * * The Board believes that it is appropriate to exclude these accounts because of the reference to demand deposits in the EFA Act, which suggests that the EFA

Act is intended to apply only to accounts that permit unlimited third party transfers.

* * * * *

3. Interbank deposits, including accounts of offices of domestic banks or foreign banks located outside the United States, and direct and indirect accounts of the United States Treasury (including Treasury General Accounts and Treasury Tax and Loan deposits) are exempt from subpart B and, in connection therewith, subpart A. However, interbank deposits are included as accounts for purposes of subparts C and D and, in connection therewith, subpart A.

4. The Check 21 Act defines account to mean any deposit account at a bank. Therefore, for purposes of subpart D and, in connection therewith, subpart A, account means any deposit, as that term is defined by § 204.2(a)(1)(i) of Regulation D, at a bank. Many deposits that are not accounts for purposes of the other subparts of Regulation CC, such as savings deposits, are accounts for purposes of subpart D.

* * * * *

■ 30. In appendix E, paragraph II.F., remove the phrase "subpart C" wherever it appears and add the phrase "subparts C and D" in its place and add a new paragraph 4 to read as follows:

II. * * *

F. * * *

4. For purposes of subpart D and, in connection therewith, subpart A, the term bank also includes the Treasury of the United States and the United States Postal Service to the extent that they act as paying banks because the Check 21 Act includes these two entities in the definition of the term bank to the extent that they act as payors.

* * * * *

■ 31. In appendix E, paragraph II.K., remove the phrase "subpart C" in paragraph 8. and add the phrase "subparts C and D" in its place, redesignate paragraph 9. as paragraph 10., and add a new paragraph 9. to read as follows:

II. * * *

K. * * *

9. A substitute check as defined in § 229.2(aaa) is a check for purposes of Regulation CC and the U.C.C., even if that substitute check does not meet the requirements for legal equivalence set forth in § 229.51(a).

* * * * *

■ 32. In appendix E, paragraph II.M., remove the number "46" in the second sentence.

■ 33. In appendix E, paragraph II.N.1., add new sentences between the second and third sentences to read as follows:

II. * * *

N. * * *

1. * * * A clearing account maintained at a bank directly by a brokerage firm is not a consumer account, even if the account is used to pay checks drawn by consumers using the funds in that account. The bank's relationship is with the brokerage firm, and

the account is used by the brokerage firm to facilitate the clearing of its customers' checks. Because for purposes of Regulation CC the term account includes only deposit accounts, a consumer's revolving credit relationship or other line of credit with a bank is not a consumer account, even if the consumer draws on such credit lines by using a check. * * *

* * * * *

■ 34. In appendix E, paragraph II.Q.1., revise the first sentence to read as follows:

II. * * *

Q. * * *

1. Forward collection is defined to mean the process by which a bank sends a check to the paying bank for collection, including sending the check to an intermediary collecting bank for settlement, as distinguished from the process by which the check is returned unpaid. * * *

* * * * *

■ 35. In appendix E, revise paragraph II.S.1.b. and add a new paragraph II.S.1.c. to read as follows:

II. * * *

S. * * *

1. * * * b. The location of the depository bank is determined by the physical location of the branch or proprietary ATM at which a check is deposited, regardless of whether the deposit is made in person, by mail, or otherwise. For example, if a branch of the depository bank located in one check-processing region sends a check that was deposited at that branch to the depository bank's central facility in another check-processing region, and the central facility is in the same check-processing region as the paying bank, the check is still considered nonlocal. (See the commentary to the definition of "paying bank.")

c. If a person deposits a check to an account by mailing or otherwise sending the check to a facility or office that is not a bank, the check is considered local or nonlocal depending on the location of the bank whose indorsement appears on the check as the depository bank.

* * * * *

■ 36. In appendix E, paragraph II.Z., revise the second and third sentences of paragraph 1., remove the phrase "subpart C" in paragraph 3. and add the phrase "subparts C and D" in its place, and add a new paragraph 6. to read as follows:

II. * * *

Z. * * *

1. * * * For purposes of all subparts of Regulation CC, the term paying bank includes the bank by which a check is payable, the payable-at bank to which a check is sent, or, if the check is payable by a nonbank payor, the bank through which the check is payable and to which it is sent for payment or collection. For purposes of subparts C and D, the term paying bank also includes the payable-through bank and the bank whose routing number appears on the check, regardless of whether the check is

payable by a different bank, provided that the check is sent for payment or collection to the payable through bank or the bank whose routing number appears on the check.

* * * * *

6. In accordance with the Check 21 Act, for purposes of subpart D and, in connection therewith, subpart A, paying bank includes the Treasury of the United States or the United States Postal Service with respect to a check payable by that entity and sent to that entity for payment or collection, even though the Treasury and Postal Service are not defined as banks for purposes of subparts B and C. Because the Federal Reserve Banks act as fiscal agents for the Treasury and the U.S. Postal Service and in that capacity are designated as presentment locations for Treasury checks and U.S. Postal Service money orders, a Treasury check or U.S. Postal Service money order presented to a Federal Reserve Bank is considered to be presented to the Treasury or U.S. Postal Service, respectively.

* * * * *

■ 37. In appendix E, paragraph II.BB.1. remove the last two sentences and add the following new sentence in their place to read as follows:

II. * * *
BB. * * *

1. * * * Qualified returned checks are identified by placing 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 in accordance with American National Standard Specifications for Placement and Location of MICR Printing, X9.13 (hereinafter "ANS X9.13") for original checks or American National Standard Specifications for an Image Replacement Document—IRD, X9.100–140 (hereinafter "ANS X9.100–140") for substitute checks.

* * * * *

■ 38. In appendix E to part 229, add new paragraphs II.QQ. through II.EEE. to read as follows:

II. Section 229.2 Definitions

* * * * *

QQ. 229.2(qq) [Reserved]

RR. 229.2(rr) [Reserved]

SS. 229.2(ss) [Reserved]

TT. 229.2(tt) [Reserved]

UU. 229.2(uu) [Reserved]

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 ANS X9.100–140 for substitute checks. 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.

WW. 229.2(ww) Original Check

1. The definition of original check distinguishes the first paper check signed or otherwise authorized by the drawer to effect

a particular payment transaction from a substitute check or other paper or electronic representation that is derived from an original check or substitute check. There is only one original check for any particular payment transaction. However, multiple substitute checks could be created to represent that original check at various points in the check collection and return process.

XX. 229.2(xx) Paper or Electronic Representation of a Substitute Check

1. Receipt of a paper or electronic representation of a substitute check does not trigger indemnity or expedited recredit rights, although the recipient nonetheless could have a warranty claim or a claim under other check law with respect to that document or the underlying payment transaction. A paper or electronic representation of a substitute check would include a representation of a substitute check that was drawn on an account, as well as a representation of a substitute traveler's check, credit card check, or other item that meets the substitute check definition. The following examples illustrate the scope of the definition.

Examples.

a. A bank receives electronic presentment of a substitute check that has been converted to electronic form and charges the customer's account for that electronic item. The periodic account statement that the bank provides to the customer includes information about the electronically-presented substitute check in a line-item list describing all the checks the bank charged to the customer's account during the previous month. The electronic file that the bank received for presentment and charged to the customer's account would be an electronic representation of a substitute check, and the line-item appearing on the customer's account statement would be a paper representation of a substitute check.

b. A paying bank receives and settles for a substitute check and then realizes that its settlement was for the wrong amount. The paying bank sends an adjustment request to the presenting bank to correct the error. The adjustment request is not a paper or electronic representation of a substitute check under the definition because it is not being handled for collection or return as a check. Rather, it is a separate request that is related to a check. As a result, no substitute check warranty, indemnity, or expedited recredit rights attach to the adjustment.

YY. 229.2(yy) [Reserved]

ZZ. 229.2(zz) Reconverting Bank

1. A substitute check is "created" when and where a paper reproduction of an original check that meets the requirements of § 229.2(aaa) is physically printed. A bank is a reconverting bank if it creates a substitute check directly or if another person by agreement creates a substitute check on the bank's behalf. A bank also is a reconverting bank if it is the first bank that receives a substitute check created by a nonbank and transfers, presents, or returns that substitute check or, in lieu thereof, the first paper or electronic representation of such substitute check.

Examples.

a. Bank A, by agreement, sends an electronic check file for collection to Bank B. Bank B chooses to use that file to print a substitute check that meets the requirements of § 229.2(aaa). Bank B is the reconverting bank as of the time it prints the substitute check.

b. Company A, which is not a bank, by agreement receives check information electronically from Bank A. Bank A becomes the reconverting bank when Company A prints a substitute check on behalf of Bank A in accordance with that agreement.

c. A depository bank's customer, which is a nonbank business, receives a check for payment, truncates that original check, and creates a substitute check to deposit with its bank. The depository bank receives that substitute check from its customer and is the first bank to handle the substitute check. The depository bank becomes the reconverting bank as of the time that it transfers or presents the substitute check (or in lieu thereof the first paper or electronic representation of the substitute check) for forward collection.

d. A bank is the payable-through bank for checks that are drawn on a nonbank payor, which is the bank's customer. When the customer decides not to pay a check that is payable through the bank, the customer creates a substitute check for purposes of return. The payable-through bank becomes the reconverting bank when it returns the substitute check (or in lieu thereof the first paper or electronic representation of the substitute check) to a returning bank or the depository bank.

e. A paying bank returns a substitute check to the depository bank, which in turn gives that substitute check back to its nonbank customer. That customer then redeposits the substitute check for collection at a different bank. Because the substitute check was already transferred by a bank, the second depository bank does not become a reconverting bank when it transfers or presents that substitute check for collection.

2. In some cases there will be one or more banks between the truncating bank and the reconverting bank.

Example.

A depository bank truncates the original check and sends an electronic representation of the original check for collection to an intermediary bank. The intermediary bank sends the electronic representation of the original check to the presenting bank, which creates a substitute check to present to the paying bank. The presenting bank is the reconverting bank.

3. A check could move from electronic form to substitute check form several times during the collection and return process. It therefore is possible that there could be multiple substitute checks, and thus multiple reconverting banks, with respect to the same underlying payment.

AAA. 229.2(aaa) Substitute Check

1. "A paper reproduction of an original check" could include a reproduction created directly from the original check or a reproduction of the original check that is

created from some other source that contains an image of the original check, such as an electronic representation of an original check or substitute check, or a previous substitute check.

2. Because a substitute check must be a piece of paper, an electronic file or electronic check image that has not yet been printed in accordance with the substitute check definition is not a substitute check.

3. Because a substitute check must be a representation of a check, a paper reproduction of something that is not a check cannot be a substitute check. For example, a savings bond or a check drawn on a non-U.S. branch of a foreign bank cannot be reconverted to a substitute check.

4. As described in § 229.51(b) and the commentary thereto, a reconverting bank is required to ensure that a substitute check contains all indorsements applied by previous parties that handled the check in any form. Therefore, the image of the original check that appears on the back of a substitute check would include indorsements that were physically applied to the original check before an image of the original check was captured. An indorsement that was applied physically to the original check after an image of the original check was captured would be conveyed as an electronic indorsement (see paragraph 3 of the commentary to § 229.35(a)). The back of the substitute check would contain a physical representation of any indorsements that were applied electronically to the check after an image of the check was captured but before creation of the substitute check.

Example.

Bank A, which is the depository bank, captures an image of an original check, indorses it electronically and, by agreement, transmits to Bank B an electronic image of the check accompanied by the electronic indorsement. Bank B then creates a substitute check to send to Bank C. The back of the substitute check created by Bank B must contain a representation of the indorsement previously applied electronically by Bank A and Bank B's own indorsement. (For more information on indorsement requirements, see § 229.35, appendix D, and the commentary thereto.)

5. Some substitute checks will not be created directly from the original check, but rather will be created from a previous substitute check. The back of a subsequent substitute check will contain an image of the full length of the back of the previous substitute check. ANS X9.100–140 requires preservation of the full length of the back of the previous substitute check in order to preserve previous indorsements and reconvert bank identifications. By contrast, the front of a subsequent substitute check will not contain an image of the entire previous substitute check. Rather, the image field of the subsequent substitute check will contain the image of the front of the original check that appeared on the previous substitute check at the time the previous substitute check was converted to electronic form. The portions of the front of the subsequent substitute check other than the image field will contain information applied

by the subsequent reconvert bank, such as its reconvert bank identification, the MICR line, the legal equivalence legend, and optional security information.

Examples.

a. The back of a subsequent substitute check would contain the following indorsements, all of which would be preserved through the image of the back of the previous substitute check: (1) The indorsements that were applied physically to the original check before an image of the original check was captured; (2) a physical representation of indorsements that were applied electronically to the original check after an image of the original check was captured but before creation of the first substitute check; and (3) indorsements that were applied physically to the previous substitute check. In addition, the reconvert bank for the subsequent substitute check must overlay onto the back of that substitute check a physical representation of any indorsements that were applied electronically after the previous substitute check was converted to electronic form but before creation of the subsequent substitute check.

b. Because information could have been physically added to the image of the front of the original check that appeared on the previous substitute check, the original check image that appears on the front of a subsequent substitute check could contain information in addition to that which appeared on the original check at the time it was truncated.

6. The MICR line applied to a substitute check must contain information in all fields of the MICR line that were encoded on the original check at any time before an image of the original check was captured. This includes all the MICR-line information that was preprinted on the original check, plus any additional information that was added to the MICR line before the image of the original check was captured (for example, the amount of the check). The information in each field of the substitute check's MICR line must be the same information as in the corresponding field of the MICR line of the original check, except as provided by ANS X9.100–140 (unless the Board by rule or order determines that a different standard applies). Industry standards may not, however, vary the requirement that a substitute check at the time of its creation must bear a full-field MICR line.

7. ANS X9.100–140, provides that a substitute check must have a "4" in position 44 and that a qualified returned substitute check must have a "4" in position 44 of the forward-collection MICR line as well as a "5" in position 44 of the qualified return MICR line. The "4" and "5" indicate that the document is a substitute check so that the size of the check image remains constant throughout the collection and return process, regardless of the number of substitute checks created that represent the same original check (see also §§ 229.30(a)(2) and 229.31(a)(2) and the commentary thereto regarding requirements for qualified returned substitute checks). An original check generally has a blank position 44 for forward

collection. Because a reconvert bank must encode position 44 of a substitute check's forward collection MICR line with a "4," the reconvert bank must vary any character that appeared in position 44 of the forward-collection MICR line of the original check. A bank that misencodes or fails to encode position 44 at the time it attempts to create a substitute check has failed to create a substitute check. A bank that receives a properly-encoded substitute check may further encode that item but does so subject to the encoding warranties in Regulation CC and the U.C.C.

8. A substitute check's MICR line could contain information in addition to the information required at the time the substitute check is created. For example, if the amount field of the original check was not encoded and the substitute check therefore did not, when created, have an encoded amount field, the MICR line of the substitute check later could be amount-encoded.

9. A bank may receive a substitute check that contains a MICR-line variation but nonetheless meets the MICR-line replication requirements of § 229.2(aaa)(2) because that variation is permitted by ANS X9.100–140. If such a substitute check contains a MICR-line error, a bank that receives it may, but is not required to, repair that error. Such a repair must be made in accordance with ANS X9.100–140 for repairing a MICR line, which generally allows a bank to correct an error by applying a strip that may or may not contain information in all fields encoded on the check's MICR line. A bank's repair of a MICR-line error on a substitute check is subject to the encoding warranties in Regulation CC and the U.C.C.

10. A substitute check must conform to all the generally applicable industry standards for substitute checks set forth in ANS X9.100–140, which incorporates other industry standards by reference. Thus, multiple substitute check images contained on the same page of an account statement are not substitute checks.

BBB. 229.2(bbb) Sufficient Copy and Copy

1. A copy must be a paper reproduction of a check. An electronic image therefore is not a copy or a sufficient copy. However, if a customer has agreed to receive such information electronically, a bank that is required to provide an original check or sufficient copy may satisfy that requirement by providing an electronic image in accordance with § 229.58 and the commentary thereto.

2. 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.

CCC. 229.2(ccc) Transfer and Consideration

1. Under §§ 229.52 and 229.53, a bank is responsible for the warranties and indemnity when it transfers, presents, or returns a substitute check (or a paper or electronic representation thereof) for consideration. Drawers and other nonbank persons that receive checks from a bank are not transferees that receive consideration as those terms are defined in the U.C.C. However, the Check 21 Act clearly contemplates that such nonbank persons that receive substitute checks (or representations thereof) from a bank will receive the warranties and indemnity from all previous banks that handled the check. To ensure that these parties are covered by the substitute check warranties and indemnity in the manner contemplated by the Check 21 Act, § 229.2(ccc) incorporates the U.C.C. definitions of the term transfer and consideration by reference and expands those definitions to cover a broader range of situations. Delivering a check to a nonbank that is acting on behalf of a bank (such as a third-party check processor or presentment point) is a transfer of the check to that bank.

Examples.

a. A paying bank pays a substitute check and then provides that paid substitute check (or a representation thereof) to a drawer with a periodic statement. Under the expanded definitions, the paying bank thereby transfers the substitute check (or representation thereof) to the drawer for consideration and makes the substitute check warranties described in § 229.52. A drawer that suffers a loss due to receipt of a substitute check may have warranty, indemnity, and, if the drawer is a consumer, expedited recredit rights under the Check 21 Act and subpart D. A drawer that suffers a loss due to receipt of a paper or electronic representation of a substitute check would receive the substitute check warranties but would not have indemnity or expedited recredit rights.

b. The expanded definitions also operate such that a paying bank that pays an original check (or a representation thereof) and then creates a substitute check to provide to the drawer with a periodic statement transfers the substitute check for consideration and thereby provides the warranties and indemnity.

c. The expanded definitions ensure that a bank that receives a returned check in any form and then provides a substitute check to the depositor gives the substitute check warranties and indemnity to the depositor.

d. The expanded definitions apply to substitute checks representing original checks that are not drawn on deposit accounts, such as checks used to access a credit card or a home equity line of credit.

DDD. 229.2(ddd) Truncate

1. Truncate means to remove the original check from the forward collection or return process and to send in lieu of the original check either a substitute check or, by agreement, information relating to the original check. Truncation does not include removal of a substitute check from the check collection or return process.

EEE. 229.2(eee) Truncating Bank

1. A bank is a truncating bank if it truncates an original check or if it is the first bank to transfer, present, or return another form of an original check that was truncated by a person that is not a bank.

Example.

a. A bank's customer that is a nonbank business receives a check for payment and deposits either a substitute check or an electronic representation of the original check with its depository bank instead of the original check. That depository bank is the truncating bank when it transfers, presents, or returns the substitute check or electronic representation in lieu of the original check. That bank also would be the reconverting bank if it were the first bank to transfer, present, or return a substitute check that it received from (or created from the information given by) its nonbank customer (see § 229.2(yy) and the commentary thereto).

2. A truncating bank does not make the subpart D warranties and indemnity unless it also is the reconverting bank. Therefore, a bank that truncates the original check and sends an electronic file to a collecting bank does not provide subpart D protections to the recipient of that electronic item. However, a recipient of an electronic item may protect itself against losses associated with that item by agreement with the truncating bank.

* * * * *

■ 39. In appendix E, paragraph IV.D.6.e. is amended by adding new sentences between the second and third sentences to read as follows:

IV. * * *

D. * * *

6. * * *

e. * * * Such notice need not be posted at each teller window, but the notice must be posted in a place where consumers seeking to make deposits are likely to see it before making their deposits. For example, the

notice might be posted at the point where the line forms for teller service in the lobby. The notice is not required at any drive-through teller windows nor is it required at night depository locations, or at locations where consumer deposits are not accepted. * * *

* * * * *

■ 40. In appendix E, paragraph VII.H.1.a., revise the third sentence and add a new fifth sentence to read as follows:

VII. * * *

H. * * *

1. * * *

a. * * * For a customer that is not a consumer, a depository bank satisfies the written-notice requirement by sending an electronic notice that displays the text and is in a form that the customer may keep, if the customer agrees to such means of notice. * * * For a customer who is a consumer, a depository bank satisfies the written-notice requirement by sending an electronic notice in compliance with the requirements of the Electronic Signatures in Global and National Commerce Act (12 U.S.C. 7001 *et seq.*), which include obtaining the consumer's affirmative consent to such means of notice.

* * * * *

■ 41. In appendix E, paragraph IX.A.1., remove the third and fourth sentences and add new sentences in their place to read as follows:

IX. * * *

A. * * *

1. * * * A disclosure is in a form that the customer may keep if, for example, it can be downloaded or printed. For a customer that is not a consumer, a depository bank satisfies the written-disclosure requirement by sending an electronic disclosure that displays the text and is in a form that the customer may keep, if the customer agrees to such means of disclosure. For a customer who is a consumer, a depository bank satisfies the written-notice requirement by sending an electronic notice in compliance with the requirements of the Electronic Signatures in Global and National Commerce Act (12 U.S.C. 7001 *et seq.*), which include obtaining the consumer's affirmative consent to such means of notice.

* * * * *

■ 42. In appendix E, paragraph IX.A., add a new paragraph 4. to read as follows:

IX. * * *

A. * * *

4. A bank may, by agreement or at the consumer's request, provide any disclosure or notice required by subpart B in a language other than English, provided that the bank makes a complete disclosure available in English at the customer's request.

■ 43. In appendix E, add a new sentence at the end of paragraph XVI.A.7. to read as follows:

XVI. * * *

A. * * *

7. * * * 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.

* * * * *

■ 44. In appendix E, revise paragraphs XVI.C.1.a. and XVI.D.1. to read as follows:

XVI. * * *

C. * * *

1. * * *

a. A paying bank may have a courier that leaves after midnight (or after any other applicable deadline) to deliver its forward-collection checks. This paragraph removes the constraint of the midnight deadline for returned checks if the returned check reaches the receiving bank 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 later set by the receiving bank under U.C.C. 4–108. The extension also applies if the check reaches the bank to which it is sent later than the time described in the previous sentence if highly expeditious means of transportation are used. For example, a West Coast paying bank may use this further extension to ship a returned check by air courier directly to an East Coast returning bank even if the check arrives after the returning bank's cutoff hour. This paragraph applies to the extension of all midnight deadlines except Saturday midnight deadlines (see paragraph XVI.C.1.b of this appendix).

* * * * *

D. * * *

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" is permissible in appropriate cases. If the returned check is a substitute check, the reason for return must be placed 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. 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.

* * * * *

■ 45. In appendix E, add a new sentence at the end of paragraph XVII.A.7.a. to read as follows:

XVII. * * *

A. * * *

7. * * *

a. * * * 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.

* * * * *

■ 46. In appendix E, add a new paragraph XIX.B.3. to read as follows:

XIX. * * *

B. * * *

3. 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 by setting the item off with question marks, asterisks, or other symbols designated for this purpose by generally applicable industry standards.

■ 47. In appendix E, paragraph XIX.D.1., add a new sentence between the next-to-last and last sentences and revise the last sentence to read as follows:

XIX. * * *

D. * * *

1. * * * A bank that chooses to provide the notice required by § 229.33(d) in writing may send the notice by e-mail or facsimile if the bank sends the notice to the e-mail 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).

* * * * *

■ 48. In appendix E, paragraph XX.C., add new sentences at the end of paragraph 3. to read as follows:

XX. * * *

C. * * *

3. * * * Paragraph (c)(3) applies to all MICR-line encoding on a substitute check.

* * * * *

■ 49. In appendix E, paragraph XXI.A.1., remove the phrase "are legible" from the fourth sentence and add the phrase "can be interpreted by any person" in its place.

■ 50. In appendix E, paragraph XXI.A., ■ A. Remove paragraphs 2. through 6. and paragraph 8;

■ B. Redesignate paragraph 7. as paragraph 10. and redesignate paragraphs 9. through 13. as paragraphs 11. through 15., respectively;

■ C. Add new paragraphs 2. through 9; and

■ D. Revise redesignated paragraph 15. by adding the phrase "collecting banks and" between the phrases "standard for" and "returning banks" in the first sentence and adding a new sentence at the end of the paragraph.

These additions and revisions read as follows:

XXI. * * *

A. * * *

2. Banks generally apply indorsements to a paper check in one of two ways: (1) banks print or "spray" indorsements onto a 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) reconvert 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. For purposes of the indorsement standard set forth in appendix D, a reproduction of a previously applied sprayed or overlaid indorsement contained within an image of a check does not constitute "an indorsement that previously was applied electronically." To accommodate these two indorsement scenarios, the appendix includes two indorsement location specifications: one standard applies to banks spraying indorsements onto existing paper original checks and substitute checks, and another applies to reconvert banks overlaying indorsements that previously were applied electronically and their own indorsements onto substitute checks at the time the substitute checks are created.

3. 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 reconvert 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 reconvert bank creates.

4. The location of an indorsement applied to an original paper check in accordance with appendix D may shift if that check is truncated and later reconverted to a substitute check. If an indorsement applied to the original check in accordance with appendix D is overwritten by a subsequent indorsement applied to the substitute check in accordance with appendix D, then one or both of those indorsements could be rendered illegible. As explained in § 229.38(d) and the commentary thereto, a reconvert bank is liable for losses associated with indorsements that are rendered illegible as a result of check substitution.

5. To ensure that indorsements can be easily read and would remain legible after an image of a check is captured, the standard requires all indorsements applied to original checks and substitute checks to be printed in black ink as of January 1, 2006.

6. The standard requires the depository bank's indorsement to include (1) its nine-digit routing number set off by an arrow at each end of the routing number and, if the depository bank is a reconvert bank with respect to the check, an asterisk outside the arrow at each end of the routing number to identify the bank as a reconvert bank; (2) the indorsement date; and (3) if the indorsement is applied physically, name or location information. The standard also permits but does not require the indorsement to include other identifying information. The standard requires a collecting bank's or returning bank's indorsement to include only

(1) the bank's nine digit routing number (without arrows) and, if the collecting bank or returning bank is a reconverting bank with respect to the check, an asterisk at each end of the number to identify the bank as a reconverting bank, (2) the indorsement date, and (3) an optional trace or sequence number.

7. Depository banks should not include information that can be confused with required information. For example, a nine-digit zip code could be confused with the nine-digit routing number.

8. 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 returned checks. In instances where this address is not consistent with the routing number in the indorsement, the depository bank is required to receive returned checks at a branch or head office consistent with the routing number. Banks should note, however, that § 229.32 requires a depository bank to receive returned checks at the location(s) at which it receives forward-collection checks.

9. In addition to indorsing a substitute check in accordance with appendix D, a reconverting 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 the check in accordance with appendix D and ANS X9.100–140. Further, if the reconverting bank is the paying bank, it also must identify itself by applying its routing number to the back of the check in accordance with appendix D. In these instances, the reconverting bank and truncating bank routing numbers are for identification purposes only and are not indorsements or acceptances.

* * * * *

15. * * * With respect to the identification of a paying bank that is also a reconverting bank, see the commentary to § 229.51(b)(2).

* * * * *

■ 51. In appendix E, paragraph XXIII.A., remove the last sentence.

■ 52. In appendix E, paragraph XXIV.D., revise the last sentence of paragraph 1., redesignate paragraphs 2. and 3. as paragraphs 3. and 4., respectively, and add a new paragraph 2. to read as follows:

XXIV. * * *

D. * * *

1. Responsibility for back of check. * * *

Accordingly, this provision places responsibility on the paying bank, depository bank, or reconverting bank, as appropriate, for keeping the back of the check clear for bank indorsements during forward collection and return.

2. 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 appendix D'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 the appendix'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 appendix D is rendered illegible by a subsequent indorsement that later is applied to the substitute check in accordance with appendix D, or because the subsequent bank cannot apply its indorsement to the substitute check legibly in accordance with appendix D as a result of the shift in the previous indorsement.

Example.

In accordance with appendix D's specifications, a depository bank sprays its indorsement onto a business-sized original check between 3.0 inches from the leading edge of the check and 1.5 inches from the trailing edge of the check. The check's conversion to electronic form and subsequent reconversion to paper form causes the location of the depository bank indorsement, now contained within the image of the original check, to change such that it is less than 3.0 inches from the leading edge of the substitute check. In accordance with appendix D's specifications, a subsequent collecting bank sprays its indorsement onto the substitute check between the leading edge of the check and 3.0 inches from the leading edge of the check and the indorsement happens to be on top of the shifted depository bank indorsement. If the check is returned unpaid and the return is not expeditious because of the illegibility of the depository bank indorsement, and the depository bank incurs a loss that it would not have incurred had the return been expeditious, the reconverting bank bears the liability for that loss.

* * * * *

■ 53. In appendix E, redesignate commentary XXX as commentary XXXVIII and add new commentaries XXX through XXXVII to read as follows:

* * * * *

XXX. § 229.51 General provisions governing substitute checks

A. § 229.51(a) Legal Equivalence

1. Section 229.51(a) states that a substitute check for which a bank has provided the substitute check warranties is the legal equivalent of the original check for all purposes and all persons if it meets the accuracy and legend requirements. Where the law (or a contract) requires production of the original check, production of a legally equivalent substitute check would satisfy that requirement. A person that receives a substitute check cannot be assessed costs associated with the creation of the substitute check, absent agreement to the contrary.

Examples.

a. A presenting bank presents a substitute check that meets the legal equivalence requirements to a paying bank. The paying bank cannot refuse presentment of the substitute check on the basis that it is a substitute check, because the substitute check is the legal equivalent of the original check.

b. A depositor's account agreement with a bank provides that the depositor is entitled to receive original cancelled checks back with his or her periodic account statement. The bank may honor that agreement by providing original checks, substitute checks, or a combination thereof. However, a bank may not honor such an agreement by providing something other than an original check or a substitute check.

c. A mortgage company argues that a consumer missed a monthly mortgage payment that the consumer believes she made. A legally equivalent substitute check concerning that mortgage payment could be used in the same manner as the original check to prove the payment.

2. A person other than a bank that creates a substitute check could transfer, present, or return that check only by agreement unless and until a bank provided the substitute check warranties.

3. To be the legal equivalent of the original check, a substitute check must accurately represent all the information on the front and back of the check as of the time the original check was truncated. An accurate representation of information that was illegible on the original check would satisfy this requirement. The payment instructions placed on the check by, or as authorized by, the drawer, such as the amount of the check, the payee, and the drawer's signature, must be accurately represented, because that information is an essential element of a negotiable instrument. Other information that must be accurately represented includes (1) the information identifying the drawer and the paying bank that is preprinted on the check, including the MICR line; and (2) other information placed on the check prior to the time an image of the check is captured, such as any required identification written on the front of the check and any indorsements applied to the back of the check. A substitute check need not capture other characteristics of the check, such as watermarks, microprinting, or other physical security features that cannot survive the imaging process or decorative images, in order to meet the accuracy requirement. Conversely, some security features that are latent on the original check might become visible as a result of the check imaging process. For example, the original check might have a faint representation of the word "void" that will appear more clearly on a photocopied or electronic image of the check. Provided the inclusion of the clearer version of the word on the image used to create a substitute check did not obscure the required information listed above, a substitute check that contained such information could be the legal equivalent of an original check under § 229.51(a). However, if a person suffered a loss due to receipt of such a substitute check instead of the original check, that person

could have an indemnity claim under § 229.53 and in the case of a consumer, an expedited recredit claim under § 229.54.

4. To be the legal equivalent of the original check, a substitute check must bear the legal equivalence legend described in § 229.51(a)(2). A bank may not vary the language of the legal equivalence legend and must place the legend on the substitute check as specified by generally applicable industry standards for substitute checks contained in ANS X9.100–140.

5. In some cases, the original check used to create a substitute check could be forged or otherwise fraudulent. A substitute check created from a fraudulent original check would have the same status under Regulation CC and the U.C.C. as the original fraudulent check. For example, a substitute check of a fraudulent original check would not be properly payable under U.C.C. 4–401 and would be subject to the transfer and presentment warranties in U.C.C. 4–207 and 4–208.

B. 229.51(b) Reconverting Bank Duties

1. As discussed in more detail in appendix D and the commentary to § 229.35, a reconverting bank must indorse (or, if it is a paying bank with respect to the check, 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. Indorsements applied physically to the original check after an image of the original check was captured would be conveyed as electronic indorsements (see paragraph 3 of the commentary to § 229.35(a)). If indorsements were applied electronically after an image of the original check was captured or were applied electronically after a previous substitute check was converted to electronic form, the reconverting bank must apply those indorsements physically to the substitute check. A reconverting bank is not responsible for obtaining indorsements that persons that previously handled the check should have applied but did not apply.

2. A reconverting bank also must identify itself as such on the front and back of the substitute check and must preserve on the back of the substitute check the identifications of any previous reconverting banks in accordance with appendix D. The presence on the back of a substitute check of indorsements that were applied by previous reconverting banks and identified with asterisks in accordance with appendix D would satisfy the requirement that the reconverting bank preserve the identification of previous reconverting banks. As discussed in more detail in the commentary to § 229.35, the reconverting bank and truncating bank routing numbers on the front of a substitute check and, if the reconverting bank is the paying bank, the reconverting bank's routing number on the back of a substitute check are for identification only and are not indorsements or acceptances.

3. The reconverting bank must place the routing number of the truncating bank surrounded by brackets on the front of the substitute check in accordance with appendix D and ANS X9.100–140.

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 reconverting bank with respect to the substitute checks and the truncating bank with respect to the original checks. In accordance with appendix D and with ANS X9.100–140, the bank must therefore be identified on the front of the substitute checks as a reconverting bank and as the truncating bank, and on the back of the substitute checks as the depository bank and a reconverting bank.

C. 229.51(c) Applicable Law

1. A substitute check that meets the requirements for legal equivalence set forth in this section is subject to any provision of federal or state law that applies to original checks, except to the extent such provision is inconsistent with the Check 21 Act or subpart D. A legally equivalent substitute check is subject to all laws that are not preempted by the Check 21 Act in the same manner and to the same extent as is an original check. Thus, any person could satisfy a law that requires production of an original check by producing a substitute check that is derived from the relevant original check and that meets the legal equivalence requirements of § 229.51(a).

2. A law is not inconsistent with the Check 21 Act or subpart D merely because it allows for the recovery of a greater amount of damages.

Example.

A drawer that suffers a loss with respect to a substitute check that was improperly charged to its account and for which the drawer has an indemnity claim but not a warranty claim would be limited under the Check 21 Act to recovery of the amount of the substitute check plus interest and expenses. However, if the drawer also suffered damages that were proximately caused because the bank wrongfully dishonored subsequently presented checks as a result of the improper substitute check charge, the drawer could recover those losses under U.C.C. 4–402.

XXXI § 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 reconverting bank. In the case of a substitute check created by a bank, the reconverting bank starts the flow of warranties when it transfers, presents, or returns a substitute check for which it receives consideration. 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. 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.

2. The substitute check warranties and indemnity are not given under §§ 229.52 and 229.53 by a bank that truncates the original check and by agreement transfers the original check electronically to a subsequent bank for consideration. However, parties may, by agreement, allocate liabilities associated with the exchange of electronic check information.

Example.

A bank that receives check information electronically and uses it to create substitute checks is the reconverting bank and, when it transfers, presents, or returns that substitute check, becomes the first warrantor. However, that bank may protect itself by including in its agreement with the sending bank provisions that specify the sending bank's warranties and responsibilities to the receiving bank, particularly with respect to the accuracy of the check image and check data transmitted under the agreement.

3. 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 U.C.C. and other Regulation CC warranties that apply to the original check also apply to the substitute check.

4. 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 reconverting 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 reconverting 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 reconverting bank would not be liable for a warranty breach under § 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.

5. The warranty in § 229.52(a)(2), 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.

Example.

A nonbank depositor truncates a check and in lieu thereof sends an electronic version of that check to both Bank A and Bank B. Bank A and Bank B each uses 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 each is a reconverting bank that 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.

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.

XXXII. § 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. 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 version of the original check that was not derived from a substitute check.

Examples.

a. A paying bank makes payment based on a substitute check that was derived from a fraudulent original cashier's check. The amount and other characteristics of the original cashier's check are such that, had the original check been presented instead, the paying bank would have inspected the original check for security features. The paying bank's fraud detection procedures were designed to detect the fraud in question and allow the bank to return the fraudulent check in a timely manner. However, the security features that the bank would have inspected were security features that did not survive the imaging process (see the commentary to § 229.51(a)). Under these circumstances, the paying bank could assert an indemnity claim against the bank that presented the substitute check.

b. By contrast with the previous examples, the indemnity would not apply if the characteristics of the presented substitute check were such that the bank's security policies and procedures would not have detected the fraud even if the original had been presented. For example, if the check was under the threshold amount at which the bank subjects an item to its fraud detection procedures, the bank would not have inspected the item for security features regardless of the form of the item and accordingly would have suffered a loss even if it had received the original check.

c. A paying bank makes an erroneous payment based on an electronic representation of a substitute check because the electronic cash letter accompanying the electronic item included the wrong amount to be charged. The paying bank would not have an indemnity claim associated with that payment because its loss did not result from receipt of an actual substitute check instead of the original check. However, the paying bank could protect itself from such losses through its agreement with the bank that sent the check to it electronically and may have rights under other law.

d. A drawer has agreed with its bank that the drawer will not receive paid checks with periodic account statements. The drawer requested a copy of a paid check in order to prove payment and received a photocopy of a substitute check. The photocopy that the bank provided in response to this request was illegible, such that the drawer could not

prove payment. Any loss that the drawer suffered as a result of receiving the blurry check image would not trigger an indemnity claim because the loss was not caused by the receipt of a substitute check. The drawer may, however, still have a warranty claim if he received a copy of a substitute check, and may also have rights under the U.C.C.

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)(2). The drawer also could assert an indemnity claim. Because there is only one original check for any payment transaction, if the collecting 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.

2. If the recipient of the substitute check does not have a substitute check warranty claim with respect to the substitute check, the amount of the loss the recipient may recover under § 229.53 is limited to the

amount of the substitute check, plus interest and expenses. However, the indemnified person might be entitled to additional damages under some other provision of law.

Examples.

a. A drawer received a substitute check that met all the legal equivalence requirements and for which the drawer was only charged once, but the drawer believed that the underlying original check was a forgery. If the drawer suffered a loss because it could not prove the forgery based on the substitute check, for example because proving the forgery required analysis of pen pressure that could be determined only from the original check, the drawer would have an indemnity claim. However, the drawer would not have a substitute check warranty claim because the substitute check was the legal equivalent of the original check and no person was asked to pay the substitute check more than once. In that case, the amount of the drawer's indemnity under § 229.53 would be limited to the amount of the substitute check, plus interest and expenses. However, the drawer could attempt to recover additional losses, if any, under other law.

b. As described more fully in the commentary to § 229.53(a) regarding the scope of the indemnity, a paying bank could have an indemnity claim if it paid a legally equivalent substitute check that was created from a fraudulent cashier's check that the paying bank's fraud detection procedures would have caught and that the bank would have returned by its midnight deadline had it received the original check. However, if the substitute check was not subject to a warranty claim (because it met the legal equivalence requirements and there was only one payment request) the paying bank's indemnity would be limited to the amount of the substitute check plus interest and expenses.

3. The amount of an indemnity would be reduced in proportion to the amount of any amount 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).

4. An indemnifying bank may limit the losses for which it is responsible under § 229.53 by producing the original check or a sufficient copy. However, production of the original check or a sufficient copy does not absolve the indemnifying bank from liability claims relating to a warranty the bank has provided under § 229.52 or any other law, including but not limited to subpart C of this part or the U.C.C.

C. 229.53(c) Subrogation of Rights

1. A bank that pays an indemnity claim is subrogated to the rights of the person it indemnified, to the extent of the indemnity it provided, so that it may attempt to recover that amount from another person based on an indemnity, warranty, or other claim. The person that the bank indemnified must comply with reasonable requests from the indemnifying bank for assistance with respect to the subrogated claim.

Example.

A paying bank indemnifies a drawer for a substitute check that the drawer alleged was a forgery that would have been detected had the original check instead been presented. The bank that provided the indemnity could pursue its own indemnity claim against the bank that presented the substitute check, could attempt to recover from the forger, or could pursue any claim that it might have under other law. The bank also could request from the drawer any information that the drawer might possess regarding the possible identity of the forger.

XXXIII. § 229.54 Expedited Recredit for Consumers

A. 229.54(a) Circumstances Giving Rise to a Claim

1. A consumer may make a claim for expedited recredit under this section only for a substitute check that he or she has received and for which the bank charged his or her deposit account. As a result, checks used to access loans, such as credit card checks or home equity line of credit checks, that are reconverted to substitute checks would not give rise to an expedited recredit claim, unless such a check was returned unpaid and the bank charged the consumer's deposit account for the amount of the returned check. In addition, a consumer who received only a statement that contained images of multiple substitute checks per page would not be entitled to make an expedited recredit claim, although he or she could seek redress under other provisions of law, such as § 229.52 or U.C.C. 4–401. However, a consumer who originally received only a statement containing images of multiple substitute checks per page but later received a substitute check, such as in response to a request for a copy of a check shown in the statement, could bring a claim if the other expedited recredit criteria were met. Although a consumer must at some point have received a substitute check to make an expedited recredit claim, the consumer need not be in possession of the substitute check at the time he or she submits the claim.

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 § 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 § 229.34(b), which contains returned check warranties that are made to the owner of the check.

3. A consumer's recovery under the expedited recredit section is limited to the amount of his or her loss, up to the amount of the substitute check subject to the claim, plus interest if the consumer's account is an interest-bearing account. The consumer's loss could include fees that resulted from the allegedly incorrect charge, such as bounced check fees that were imposed because the improper charge caused the bank to dishonor subsequently presented checks that it otherwise would have honored. A consumer

who suffers a total loss greater than the amount of the substitute check plus interest could attempt to recover the remainder of that loss by bringing warranty, indemnity, or other claim under this subpart or other applicable law.

Examples.

a. A consumer who received a substitute check believed that he or she wrote the check for \$150, but the bank charged his or her account for \$1,500. The amount on the substitute check the consumer received is illegible. If the substitute check contained a blurry image of what was a legible original check, the consumer could have a claim for a breach of the legal equivalence warranty in addition to an improper charge claim. Because the amount of the check cannot be determined from the substitute check provided to the consumer, the consumer, if acting in good faith, could assert that the production of the original check or a better copy of the original check is necessary to determine the validity of the claim. The consumer in this case could attempt to recover his or her losses by using the expedited recredit procedure. The consumer's losses recoverable under § 229.54 could include the \$1,350 he or she believed was incorrectly charged plus any improperly charged fees associated with that charge, up to \$150 (plus foregone interest on the amount of the consumer's loss if the account was an interest-bearing account). The consumer could recover any additional losses, if any, under other law, such as U.C.C. 4–401 and 4–402.

b. A consumer received a substitute check for which his or her account was charged and believed that the original check from which the substitute was derived was a forgery. The forgery was good enough that analysis of the original check was necessary to verify whether the signature is that of the consumer. Under those circumstances, the consumer, if acting in good faith, could assert that the charge was improper, that he or she therefore had incurred a loss in the amount of the check (plus foregone interest if the account was an interest-bearing account), and that he or she needed the original check to determine the validity of the forgery claim. By contrast, if the signature on the substitute check obviously was forged (for example, if the forger signed a name other than that of the account holder) and there was no other defect with the substitute check, the consumer would not need the original check or a sufficient copy to determine the fact of the forgery and thus would not be able to make an expedited recredit claim under this section. However, the consumer would have a claim under U.C.C. 4–401 if the item was not properly payable.

B. 229.54(b) Procedures for Making Claims

1. The consumer must submit his or her expedited recredit claim to the bank within 40 calendar days of the later of the day on which the bank mailed or delivered, by a means agreed to by the consumer, (1) the periodic account statement containing information concerning the transaction giving rise to the claim, or (2) the substitute check giving rise to the claim. The mailing

or delivery of a substitute check could be in connection with a regular account statement, in response to a consumer's specific request for a copy of a check, or in connection with the return of a substitute check to the payee.

2. Section 229.54(b) contemplates more than one possible means of delivering an account statement or a substitute check to the consumer. The time period for making a claim thus could be triggered by the mailed, in-person, or electronic delivery of an account statement or by the mailed or in-person delivery of a substitute check. In-person delivery would include, for example, making an account statement or substitute check available at the bank for the consumer's retrieval under an arrangement agreed to by the consumer. In the case of a mailed statement or substitute check, the 40-day period should be calculated from the postmark on the envelope. In the case of in-person delivery, the 40-day period should be calculated from the earlier of the calendar day on which delivery occurred or the bank first made the statement or substitute check available for the consumer's retrieval.

3. A bank must extend the consumer's time for submitting a claim for a reasonable period if the consumer is prevented from submitting his or her claim within 40 days because of extenuating circumstances. Extenuating circumstances could include, for example, the extended travel or illness of the consumer.

4. For purposes of determining the timeliness of a consumer's actions, a consumer's claim is considered received on the banking day on which the consumer's bank receives a complete claim in person or by telephone or on the banking day on which the consumer's bank receives a letter or e-mail containing a complete claim. (But see paragraphs 9–11 of this section for a discussion of time periods related to oral claims that the bank requires to be put in writing.)

5. A consumer who makes an untimely claim would not be entitled to recover his or her losses using the expedited recredit procedure. However, he or she still could have rights under other law, such as a warranty or indemnity claim under subpart D, a claim for an improper charge to his or her account under U.C.C. 4–401, or a claim for wrongful dishonor under U.C.C. 4–402.

6. A consumer's claim must include the reason why the consumer believes that his or her account was charged improperly or why he or she has a warranty claim. A charge could be improper, for example, if the bank charged the consumer's account for an amount different than the consumer believes he or she authorized or charged the consumer more than once for the same check, or if the check in question was a forgery or otherwise fraudulent.

7. A consumer also must provide a reason why production of the original check or a sufficient copy is necessary to determine the validity of the claim identified by the consumer. For example, if the consumer believed that the bank charged his or her account for the wrong amount, the original check might be necessary to prove this claim if the amount of the substitute check were illegible. Similarly, if the consumer believed

that his or her signature had been forged, the original check might be necessary to confirm the forgery if, for example, pen pressure or similar analysis were necessary to determine the genuineness of the signature.

8. The information that the consumer is required to provide under § 229.54(b)(2)(iv) to facilitate the bank's investigation of the claim could include, for example, a copy of the allegedly defective substitute check or information related to that check, such as the number, amount, and payee.

9. A bank may accept an expedited recredit claim in any form but could in its discretion require the consumer to submit the claim in writing. A bank that requires a recredit claim to be in writing must inform the consumer of that requirement and provide a location to which such a written claim should be sent. If the consumer attempts to make a claim orally, the bank must inform the consumer at that time of the written notice requirement. A bank that receives a timely oral claim and then requires the consumer to submit the claim in writing may require the consumer to submit the written claim within 10 business days of the bank's receipt of the timely oral claim. If the consumer's oral claim was timely and the consumer's written claim was received within the 10-day period for submitting the claim in writing, the consumer would satisfy the requirement of § 229.54(b)(1) to submit his or her claim within 40 days, even if the bank received the written claim after that 40-day period.

10. A bank may permit but may not require a consumer to submit a written claim electronically.

11. If a bank requires a consumer to submit a claim in writing, the bank may compute time periods for the bank's action on the claim from the date that the bank received the written claim. Thus, if a consumer called the bank to make an expedited recredit claim and the bank required the consumer to submit the claim in writing, the time at which the bank must take action on the claim would be determined based on the date on which the bank received the written claim, not the date on which the consumer made the oral claim.

12. Regardless of whether the consumer's communication with the bank is oral or written, a consumer complaint that does not contain all the elements described in § 229.54(b) is not a claim for purposes of § 229.54. If the consumer attempts to submit a claim but does not provide all the required information, then the bank has a duty to inform the consumer that the complaint does not constitute a claim under § 229.54 and identify what information is missing.

C. 229.54(c) Action on Claims

1. If the bank has not determined whether or not the consumer's claim is valid by the end of the 10th business day after the banking day on which the consumer submitted the claim, the bank must by that time recredit the consumer's account for the amount of the consumer's loss, up to the lesser of the amount of the substitute check or \$2,500, plus interest if the account is an interest-bearing account. A bank must provide the recredit pending investigation for each substitute check for which the

consumer submitted a claim, even if the consumer submitted multiple substitute check claims in the same communication.

2. A bank that provides a recredit to the consumer, either provisionally or after determining that the consumer's claim is valid, may reverse the amount of the recredit if the bank later determines that the claim in fact was not valid. A bank that reverses a recredit also may reverse the amount of any interest that it has paid on the previously recredited amount. A bank's time for reversing a recredit may be limited by a statute of limitations.

D. 229.54(d) Availability of Recredit

1. The availability of a recredit provided by a bank under § 229.54(c) is governed solely by § 229.54(d) and therefore is not subject to the availability provisions of subpart B. A bank generally must make a recredit available for withdrawal no later than the start of the business day after the banking day on which the bank provided the recredit. However, a bank may delay the availability of up to the first \$2,500 that it provisionally recredits to a consumer account under § 229.54(c)(3)(i) if (1) the account is a new account, (2) without regard to the substitute check giving rise to the recredit claim, the account has been repeatedly overdrawn during the six month period ending on the date the bank received the claim, or (3) the bank has reasonable cause to believe that the claim is fraudulent. These first two exceptions are meant to operate in the same manner as the corresponding new account and repeated overdraft exceptions in subpart B, as described in § 229.13(a) and (d) and the commentary thereto regarding application of the exceptions. When a recredit amount for which a bank delays availability contains an interest component, that component also is subject to the delay because it is part of the amount recredited under § 229.54(c)(3)(i). However, interest continues to accrue during the hold period.

2. Section 229.54(d)(2) describes the maximum period of time that a bank may delay availability of a recredit provided under § 229.54(c). The bank may delay availability under one of the three listed exceptions until the business day after the banking day on which the bank determines that the consumer's claim is valid or the 45th calendar day after the banking day on which the bank received the consumer's claim, whichever is earlier. The only portion of the recredit that is subject to delay under § 229.54(d)(2) is the amount that the bank recredits under § 229.54(c)(3)(i) (including the interest component, if any) pending its investigation of a claim.

E. 229.54(e) Notices Relating to Consumer Expedited Recredit Claims

1. A bank must notify a consumer of its action regarding a recredit claim no later than the business day after the banking day that the bank makes a recredit, determines a claim is not valid, or reverses a recredit, as appropriate. As provided in § 229.58, a bank may provide any notice required by this section by U.S. mail or by any other means through which the consumer has agreed to receive account information.

2. A bank that denies the consumer's recredit claim must demonstrate to the consumer that the substitute check was properly charged or that the warranty claim was not valid, such as by explaining the reason that the substitute check charge was proper or the consumer's warranty claim was not valid. For example, if a consumer has claimed that the bank charged its account for an improper amount, the bank denying that claim must explain why it determined that the charged amount was proper.

3. A bank denying a recredit claim also must provide the original check or a sufficient copy, unless the bank is providing the claim denial notice electronically and the consumer has agreed to receive that type of information electronically. In that case, § 229.58 allows the bank instead to provide an image of the original check or an image of the sufficient copy that the bank would have sent to the consumer had the bank provided the notice by mail.

4. A bank that relies on information or documents in addition to the original check or sufficient copy when denying a consumer expedited recredit claim also must either provide such information or documents to the consumer or inform the consumer that he or she may request copies of such information or documents. This requirement does not apply to a bank that relies only on the original check or a sufficient copy to make its determination.

5. Models C-22 through C-25 in appendix C contain model language for each of three notices described in § 229.54(e). A bank may, but is not required to, use the language listed in the appendix. The Check 21 Act does not provide banks that use these models with a safe harbor. However, the Board has published these models to aid banks' efforts to comply with § 229.54(e).

F. 229.54(f) Recredit Does Not Abrogate Other Liabilities

1. The amount that a consumer may recover under § 229.54 is limited to the lesser of the amount of his or her loss or the amount of the substitute check, plus interest on that amount if his or her account earns interest. However, a consumer's total loss associated with the substitute check could exceed that amount, and the consumer could be entitled to additional damages under other law. For example, if a consumer's loss exceeded the amount of the substitute check plus interest and he or she had both a warranty and an indemnity claim with respect to the substitute check, he or she would be entitled to additional damages under § 229.53 of this subpart. Similarly, if a consumer was charged bounced check fees as a result of an improperly charged substitute check and could not recover all of those fees because of the § 229.54's limitation on recovery, he or she could attempt to recover additional amounts under U.C.C. 4-402.

XXXIV. § 229.55 Expedited Recredit Procedures for Banks

A. 229.55(a) Circumstances Giving Rise to a Claim

1. This section allows a bank to make an expedited recredit claim under two sets of circumstances: first, because it is obligated to

provide a recredit, either to the consumer or to another bank that is obligated to provide a recredit in connection with the consumer's claim; and second, because the bank detected a problem with the substitute check that, if uncaught, could have given rise to a consumer claim.

2. The loss giving rise to an interbank recredit claim could be the recredit that the claimant bank provided directly to its consumer customer under § 229.54 or a loss incurred because the claimant bank was required to indemnify another bank that provided an expedited recredit to either a consumer or a bank.

Examples.

a. A paying bank charged a consumer's account based on a substitute check that contained a blurry image of a legible original check, and the consumer whose account was charged made an expedited recredit claim against the paying bank because the consumer suffered a loss and needed the original check or a sufficient copy to determine the validity of his or her claim. The paying bank would have a warranty claim against the presenting bank that transferred the defective substitute check to it and against any previous transferring bank(s) that handled that substitute check or another paper or electronic representation of the check. The paying bank therefore would meet each of the requirements necessary to bring an interbank expedited recredit claim.

b. Continuing with the example in paragraph a, if the presenting bank determined that the paying bank's claim was valid and provided a recredit, the presenting bank would have suffered a loss in the amount of the recredit it provided and could, in turn, make an expedited recredit claim against the bank that transferred the defective substitute check to it.

B. 229.55(b) Procedures for Making Claims

1. An interbank recredit claim under this section must be brought within 120 calendar days of the transaction giving rise to the claim. For purposes of computing this period, the transaction giving rise to the claim is the claimant bank's settlement for the substitute check in question.

2. When estimating the amount of its loss, § 229.55(b)(2)(ii) states that the claimant bank should include "interest if applicable." The quoted phrase refers to any interest that the claimant bank or a bank that the claimant bank indemnified paid to a consumer who has an interest-bearing account in connection with an expedited recredit under § 229.54.

3. The information that the claimant bank is required to provide under § 229.55(b)(2)(iv) to facilitate investigation of the claim could include, for example, a copy of any written claim that a consumer submitted under § 229.54 or any written record the bank may have of a claim the consumer submitted orally. The information also could include a copy of the defective substitute check or information relating to that check, such as the number, amount, and payee of the check. However, a claimant bank that provides a copy of the substitute check must take reasonable steps to ensure that the copy is not mistaken for a legal equivalent of the

original check or handled for forward collection or return.

4. The indemnifying bank's right to require a claimant bank to submit a claim in writing and the computation of time from the date of the written submission parallel the corresponding provision in the consumer recredit section (§ 229.54(b)(3)). However, the indemnifying bank also may require the claimant bank to submit a copy of the written or electronic claim submitted by the consumer under that section, if any.

C. 229.55(c) Action on Claims

1. An indemnifying bank that responds to an interbank expedited recredit claim by providing the original check or a sufficient copy of the original check need not demonstrate why that claim or the underlying consumer expedited recredit claim is or is not valid.

XXXV. § 229.56 Liability

A. 229.56(a) Measure of Damages

1. In general, a person's recovery under this section is limited to the amount of the loss up to the amount of the substitute check that is the subject of the claim, plus interest and expenses (including costs and reasonable attorney's fees and other expenses of representation) related to that substitute check. However, a person that is entitled to an indemnity under § 229.53 because of a breach of a substitute check warranty also may recover under § 229.53 any losses proximately caused by the warranty breach, including interest, costs, wrongfully-charged fees imposed as a result of the warranty breach, reasonable attorney's fees, and other expenses of representation.

2. A reconverting bank also may be liable under § 229.38 for damages associated with the illegibility of indorsements applied to substitute checks if that illegibility results because the reduction of the original check image and its placement on the substitute check shifted a previously-applied indorsement that, when applied, complied with appendix D. For more detailed discussion of this topic, see § 229.38 and the accompanying commentary.

B. 229.56(b) Timeliness of Action

1. A bank's delay beyond the time limits prescribed or permitted by any provision of subpart D is excused if the delay is caused by certain circumstances beyond the bank's control. This parallels the standard of U.C.C. 4-109(b).

C. 229.56(c) Jurisdiction

1. The Check 21 Act confers subject matter jurisdiction on courts of competent jurisdiction and provides a time limit for civil actions for violations of subpart D.

D. 229.56(d) Notice of Claims

1. This paragraph is designed to adopt the notice of claim provisions of U.C.C. 4-207(d) and 4-208(e), with an added provision that a timely § 229.54 expedited recredit claim satisfies the generally-applicable notice requirement. The time limit described in this paragraph applies only to notices of warranty and indemnity claims. As provided in § 229.56(c), all actions under § 229.56 must

be brought within one year of the date that the cause of action accrues.

XXXVI. Consumer Awareness

A. 229.57(a) General Disclosure Requirement and Content

1. A bank must provide the disclosure required by § 229.57 under two circumstances. First, each bank must provide the disclosure to each of its consumer customers who receives paid checks with his or her account statement. This requirement does not apply if the bank provides with the account statement something other than paid original checks, paid substitute checks, or a combination thereof. For example, this requirement would not apply if a bank provided with the account statement only a document that contained multiple check images per page. Second, a bank also must provide the disclosure when it (a) provides a substitute check to a consumer in response to that consumer's request for a check or check copy or (b) returns a substitute check to a consumer depositor. A bank must provide the disclosure each time it provides a substitute check to a consumer on an occasional basis, regardless of whether the bank previously provided the disclosure to that consumer.

2. A bank may, but is not required to, use the model disclosure in appendix C–5A to satisfy the disclosure content requirements of this section. A bank that uses the model language is deemed to comply with the disclosure content requirement(s) for which it uses the model language, provided the information in the disclosure accurately describes the bank's policies and practices. A bank also may include in its disclosure additional information relating to substitute checks that is not required by this section.

3. A bank may, by agreement or at the consumer's request, provide the disclosure required by this section in a language other than English, provided that the bank makes a complete English notice available at the consumer's request.

B. 229.57(b) Distribution

1. A consumer may request a check or a copy of a check on an occasional basis, such as to prove that he or she made a particular payment. A bank that responds to the consumer's request by providing a substitute check must provide the required disclosure at the time of the consumer's request if feasible. Otherwise, the bank must provide the disclosure no later than the time at which the bank provides a substitute check in response to the consumer's request. It would not be feasible for a bank to provide notice to the consumer at the time of the request if, for example, the bank did not know at the time of the request whether it would provide a substitute check in response to that request, regardless of the form of the consumer's request. It also would not be feasible for a bank to provide notice at the time of the request if the consumer's request was mailed to the bank or made by telephone, even if the bank knew when it received the request that it would provide a substitute check in response. A bank's provision to the consumer of something other than a substitute check, such as a photocopy of a check or a statement

containing images of multiple substitute checks per page, does not trigger the notice requirement.

2. A consumer who does not routinely receive paid checks might receive a returned substitute check. For example, a consumer deposits an original check that is payable to him or her into his or her deposit account. The paying bank returns the check unpaid and the depository bank returns the check to the depositor in the form of a substitute check. A depository bank that provides a returned substitute check to a consumer depositor must provide the substitute check disclosure at that time.

XXXVII. Variation by Agreement

Section 229.60 provides that banks involved in an interbank expedited recredit claim under § 229.55 may vary the terms of that section by agreement, but otherwise no person may vary the terms of subpart D by agreement. A bank's decision to provide more generous protections for consumers than this subpart requires, such as by providing consumers additional time to submit expedited claims under § 229.54 under non-exigent circumstances, would not be a variation prohibited by § 229.60.

■ 54. In appendix E, in newly-redesignated paragraph XXXVIII., revise the heading and paragraph A.1. to read as follows:

* * * * *

XXXVIII. Appendix C—Model Availability Policy Disclosures, Clauses, and Notices; and Model Substitute Check Policy Disclosure and Notices

A. Introduction

1. Appendix C contains model disclosure, clauses, and notices that may be used by banks to meet their disclosure and notice responsibilities under the regulation. Banks using the models (except models C–22 through C–25) properly will be deemed in compliance with the regulation's disclosure requirements.

* * * * *

■ 55. In appendix E, in newly-redesignated paragraph XXXVIII.B., revise the heading, the first sentence of paragraphs B.1.a. and the first sentence of paragraph B.1.c. and add a new paragraph B.7., to read as follows:

XXXVIII. * * *

B. Model Availability Policy and Substitute Check Policy Disclosures, Models C–1 through C–5A

1. *Models C–1 through C–5A generally.*
a. Models C–1 through C–5A are models for the availability policy disclosures described in § 229.16 and substitute check policy disclosure described in § 229.57.

* * *

c. Models C–1 through C–5A generally do not reflect any optional provisions of the regulation, or those that apply only to certain banks. * * *

* * * * *

7. Model C–5A

A bank may use this form when it is providing the disclosure to its consumers required by § 229.57 explaining that a substitute check is the legal equivalent of an original check and the circumstances under which the consumer may make a claim for expedited recredit.

* * * * *

■ 56. In appendix E, in newly-redesignated paragraph XXXVIII.D., revise the heading, the first sentence of paragraph D.1. and add new paragraphs D.11. through D.15. to read as follows:

XXXVIII. * * *

D. Model Notices, Models C–12 through C–25

1. *Models C–12 through C–25 generally.* Models C–12 through C–25 provide models of the various notices required by the regulation. * * *

* * * * *

11. *Models C–22 through C–25 generally.* Models C–22 through C–25 provide models for the various notices required when a consumer who receives substitute checks makes an expedited recredit claim under § 229.54 for a loss related to a substitute check. The Check 21 Act does not provide banks that use these models with a safe harbor. However, the Board has published these models to aid banks' efforts to comply with § 229.54(e).

12. *Model C–22 Valid Claim Refund Notice.* A bank may use this model when crediting the entire amount or the remaining amount of a consumer's expedited recredit claim after determining that the consumer's claim is valid. This notice could be used when the bank provides the consumer a full recredit based on a valid claim determination within ten days of the receipt of the consumer's claim or when the bank recredits the remaining amount of a consumer's expedited recredit claim by the 45th calendar day after receiving the consumer's claim, as required under § 229.54(e)(1).

13. *Model C–23 Provisional Refund Notice.* A bank may use this model when providing a full or partial expedited recredit to a consumer pending further investigation of the consumer's claim, as required under § 229.54(e)(1).

14. *Model C–24 Denial Notice.* A bank may use this model when denying a claim for an expedited recredit under § 229.54(e)(2).

15. *Model C–25 Reversal Notice.* A bank may use this model when reversing an expedited recredit that was credited to a consumer's account under § 229.54(e)(3).

* * * * *

■ 57. In appendix E, remove the phrase “the Act” wherever it appears and add the phrase “the EFA Act” in its place.

By order of the Board of Governors of the Federal Reserve System, July 27, 2004.

Jennifer J. Johnson,
Secretary of the Board.

[FR Doc. 04–17362 Filed 8–3–04; 8:45 am]

BILLING CODE 6210–02–P