

Deposits Hot Topics

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Expedited Funds Availability Act (EFAA)

Regulation CC Updates

Final 2017 Reg CC Amendments

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Final 2017 Reg CC Amendments

- ▶ On June 15, 2017, the Federal Reserve Board published its long-awaited final amendments to portions of Reg CC. The rule will be effective **July 1, 2018** and updates the check collection and return provisions to reflect the evolution from a paper-based check clearing system to the electronic check collection system prevalent today.
- ▶ Additionally, the FRB has also proposed new language to amend current liability provisions for electronic checks.
- ▶ The amendments contain a number of other changes impacting banks such as modifications to check return requirements, additional warranties, and new indemnities including one for Remote Deposit Capture (RDC).

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Final 2017 Reg CC Amendments

Reg CC to Cover Electronic Checks!

- ▶ The final rule adds new definitions for “electronic check,” “electronic returned check” and “electronically-created item,” and changes a number of existing definitions.
- ▶ “Images” of original paper checks will be covered by Reg CC and will be treated the same as original “paper” checks.
- ▶ Your bank should address the new RDC indemnity as the Reg CC change creates a new form of risk.
- ▶ If you offer RDC services, (at a minimum) update your RDC endorsement requirements. Review your check/image processing agreements. Now is a good time to update all of them to conform to the new vocabulary and new rules.

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Reg CC Funds Availability

Expedited Funds Availability Act (EFAA)

- ▶ There are no changes to Subpart B of the regulation, which imposes funds availability requirements. The FRB has sole rulemaking authority over the majority of the EFAA, the FRB shares rulemaking authority with the CFPB over the provisions of the EFAA governing funds availability and the related consumer notices.
- ▶ The funds availability requirements generally apply to “checks.” The definition of “check,” which states that “check” includes “an original check and a substitute check,” also has not been changed under the final rule.
- ▶ So for now, the funds availability requirements of Reg CC do NOT appear to expressly apply to electronic checks or electronically-created items. And their application to checks deposited through RDC remains ambiguous, although arguably an item that clearly began its life as a “check” under the applicable definition should remain so for funds availability purposes. However, that view has not yet been codified into EFAA or Regulation CC.

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New & Changed Reg CC Definitions

- ▶ “Electronic check” (EC) and “electronic returned check”(ERQ) mean “an electronic image of, and electronic information derived from, a paper check or paper returned check.”
- ▶ An “electronically created item” (ECI) is “an electronic image that has all the attributes of an electronic check or electronic returned check but was created electronically and NOT derived from a paper check.”
- ▶ Certain definitions, such as “MICR line” and “routing number” are updated to reflect not just paper checks, but also electronic checks.

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Expeditious Return Requirement

- ▶ **Old rule:** 2- or 4-day tests existed along with a forward collection test. Old rule required return by the Payor Bank by 4PM on the 2nd business day after presentment.
- ▶ **New rule:** 2 day rule survives but the cutoff is now 2PM for both paper and electronic checks.
- ▶ The Payor Bank is not liable to BOFD for failure to return expeditiously unless BOFD does not return the check by. “commercially reasonable means.”
- ▶ 2-day rule applies to electronic returned checks (ERQ)

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Large Dollar Return Notification (LDRN) Rule

- ▶ **Old rule:** Payor Bank that returns an item in the amount of \$2500 or more must provide the BOFD with a LDRN by no later than 4 PM on the second business day following the banking day on which the item was presented to the PB.
- ▶ **New rule:** PB that returns an item in the amount of \$5000 or more must provide the BOFD with a LDRN by a means that would normally result in receipt by the BOFD no later than 2 PM on the second business day following the banking day on which the item was presented to the PB.
- ▶ Fewer data elements in LDRN
- ▶ If the Payor Bank returns a check, it must follow the rules for “Notice in Lieu” (NIL) if it cannot provide the original check (OC), the substitute check (SC) or the electronic return check (ERC).

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Notice In Lieu of Return (NIL)

- ▶ Reg CC has long provided for sending a Notice in Lieu of Return **IF** the original check is **NOT** available
- ▶ But the rule was never intended to support sending a NIL if the “real” check is available to be returned
- ▶ Same policy is maintained in the amended Reg CC
- ▶ PB can send a NIL containing required data elements, but **NOT** if the original check or a good electronic item is available to be returned

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Large Dollar Return Notices (LDRN)

- ▶ **Old rule:** Payor Bank must return the item of \$2,500 or more and notify the BOFD with an LDRN by 4PM on the 2nd business day following the banking day check was presented to the paying bank.
- ▶ **New rule:** Payor Bank that returns an item in the of \$5,000 or more must now provide the BOFD with a LDRN no later than 2PM on the 2nd business day following the banking day on which the item was presented to the Payor Bank.

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Check Warranty Changes

- ▶ The amended regulation adds new warranties to checks collected electronically.
- ▶ The current rule contains existing paper-check warranties- returned check warranties; notice of nonpayment warranties; settlement amount, encoding, and offset warranties; and transfer and presentment warranties. It also contains Check 21-like warranties that a bank will not be asked to pay an item twice and that the electronic image and electronic information are sufficient to create a substitute check.
- ▶ **Each of these warranties will also apply to electronic returned checks under the new rule.** As with the warranties for paper checks, these new warranties for electronic returned checks may be varied by agreement of the exchanging banks.

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New Indemnities for Electronically Created Items (ECI)

- ▶ ECIs are “check-like” items created in an electronic form (but never existed in paper form).
- ▶ ECIs are **NOT** electronic checks as currently defined by Reg CC and therefore not subject to other provisions of Reg CC. However, the new indemnity **does** cover losses from ECIs as it was never a paper check.
- ▶ Additionally, indemnification exists for an ECI that was unauthorized, as well as for a bank that pays a previously paid ECI.

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ECI Warranties

- ▶ A bank transferring an electronically-created item (ECI) will be required to indemnify each transferee bank, any subsequent collecting bank, the Payor Bank, and any subsequent Returning Bank against any loss, claim, or damage **resulting from the fact that the image or information was not derived from a paper check.**
- ▶ The amount of the indemnity will be limited to the amount of the loss of the indemnified bank, up to the amount of settlement or other consideration received by the indemnifying bank and interest and expenses of the indemnified bank.

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RDC Restrictive Endorsement

- ▶ Under the final rule, a bank accepting the original check for deposit cannot make an indemnity claim if the check has a restrictive endorsement that is “inconsistent with the means of deposit.”
 - ▶ i.e., Don’t accept for deposit at a teller window a paper check that bears the endorsement “for mobile deposit only.”
- ▶ The Federal Reserve suggests in Supplementary Information for the final rule that an endorsement such as “for mobile deposit only” could be an appropriate restrictive endorsement for this purpose.

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Returned RDC-Deposited Items

- ▶ A depository bank (also known as BOFD) that receives a deposit of an original paper check that was returned unpaid because the check was previously deposited via RDC would be indemnified unless the original check deposited with the depository bank contains a restrictive endorsement inconsistent with the means of deposit (e.g., “for mobile deposit only”).
- ▶ In a dramatic shift from existing liability allocation, Regulation CC now places the risk of multiple deposits of the same item on the financial institution accepting the item for deposit through RDC.
- ▶ Commentary to the new rule indicates that a BOFD can by agreement allocate liability for losses incurred from subsequent deposit of the original check to the bank’s customer that deposited the item through RDC.

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Check Images' Legal Status

- ▶ Check 21 made paper substitute checks legally equivalent to original paper checks
 - ▶ Images are NOT legally equivalent to checks!!!
- ▶ Bank-to-bank image exchange has been addressed by Reg J and FRB Operating Circular 3 (“electronic item”), ECCHO’s rules (“eligible item”), bank-to-bank agreements, and bank-depositor agreements—but these agreements do not and can not create legal equivalence for images!
- ▶ New Reg CC changes make conforming images plus data captured from paper checks equivalent to “checks”—for purposes of Reg CC ONLY
- ▶ New Reg CC does NOT give legal equivalence to images that are issued electronically—EPOs or, now, “ECIs”. Instead, Reg CC protects banks that receive ECIs by imposing indemnities to be issued by the BOFDs.

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Substitute Check for ATM Deposited Items

- ▶ When a BOFD rejects a deposit submitted from an ATM and returns a Substitute Check back to the depositor, the BOFD warrants and indemnifies the check under the new Reg CC.

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Same Day Settlement

- ▶ Reg CC gives a Presenting Bank the right to present items to a Payor Bank for same day settlement
- ▶ Since the Check 21 Act became effective, there has been continuing discussion regarding whether to extend the paper Same Day Settlement (SDS) rule to electronic checks
- ▶ Section 229.36(d) makes it explicit that the SDS rule applies only to paper checks. The process for electronically presenting checks is still subject to agreement between exchanging banks.

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Final 2019 Reg CC Amendments

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NEW: 2019 REG CC AMENDMENTS

Effective Date 9/30/2019

Sec. 229.12 - Availability schedule.

CAVEAT: References in this section to nonlocal checks are no longer effective. Nonlocal checks, by definition, ceased to exist when the Federal Reserve System finished its consolidation of check processing regions to a single region in 2010.

(e) Extension of schedule for certain deposits in Alaska, Hawaii, Puerto Rico, and the U.S. Virgin Islands. The depository bank may extend the time periods set forth in this section by one business day in the case of any deposit, other than a deposit described in Sec. 229.10, that is--

1. Deposited in an account at a branch of a depository bank if the branch is located in Alaska, Hawaii, Puerto Rico, or the U.S. Virgin Islands; and
- (2) Deposited by a check drawn on or payable at or through a paying bank not located in the same state as the depository bank.

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NEW: 2019 REG CC AMENDMENTS

Effective Date 9/30/2019

Effective 9/3/2019, The introductory portion of § 229.12(e) and paragraph (e)(1) are amended to read:

(e) Extension of schedule for certain deposits in Alaska, Hawaii, Puerto Rico, American Samoa, the Commonwealth of the Northern Mariana Islands, Guam, and the U.S. Virgin Islands. The depository bank may extend the time periods set forth in this section by one business day in the case of any deposit, other than a deposit described in § 229.10, that is--

- (1) Deposited in an account at a branch of a depository bank if the branch is located in Alaska, Hawaii, Puerto Rico, American Samoa, the Commonwealth of the Northern Mariana Islands, Guam, or the U.S. Virgin Islands; and
- (2) Deposited by a check drawn on or payable at or through a paying bank not located in the same state as the depository bank.

A LOOK AHEAD:

Amendments Effective 7/1/2020

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Sec. 229.2 - Definitions

- ▶ Sec. 229.2 - Definitions, para. 1 is amended to read:
- ▶ 1. ATM is not defined in the EFA Act. The regulation defines an ATM as an electronic device located in the United States at which a natural person may make deposits to an account by cash or check and perform other account transactions. Point-of-sale terminals, machines that only dispense cash, night depositories, and lobby deposit boxes are not ATMs within the meaning of the definition, either because they do not accept deposits of cash or checks (e.g., point-of-sale terminals and cash dispensers) or because they only accept deposits (e.g., night depositories and lobby boxes) and cannot perform other transactions. A lobby deposit box or similar receptacle in which written payment orders or deposits may be placed is not an ATM.

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Sec. 229.10 - Next-day availability

- ▶ paragraph 5 is amended to read:
- ▶ 5. First \$100.
- ▶ a. The EFA Act and regulation also require that up to \$225 of the aggregate deposit by check or checks not subject to next-day availability on any one banking day be made available on the next business day. For example, if \$70 were deposited in an account by check(s) on a Monday, the entire \$70 must be available for withdrawal at the start of business on Tuesday. If \$400 were deposited by check(s) on a Monday, this section requires that \$225 of the funds be available for withdrawal at the start of business on Tuesday. The portion of the customer's deposit to which the \$225 must be applied is at the discretion of the depository bank, as long as it is not applied to any checks subject to next-day availability. The \$225 next-day availability rule does not apply to deposits at nonproprietary ATMs.
- ▶ b. The \$225 that must be made available under this rule is in addition to the amount that must be made available for withdrawal on the business day after deposit under other provisions of this section. For example, if a customer deposits a \$1,000 Treasury check and a \$1,000 local check in its account on Monday, \$1,225 must be made available for withdrawal on Tuesday—the proceeds of the \$1,000 Treasury check, as well as the first \$225 of the local check.

Sec. 229.10 - Next-day availability. Cont.

- ▶ c. A depository bank may aggregate all local and nonlocal check deposits made by a customer on a given banking day for the purposes of the \$225 next-day availability rule. Thus, if a customer has two accounts at the depository bank, and on a particular banking day makes deposits to each account, \$225 of the total deposited to the two accounts must be made available on the business day after deposit. Banks may aggregate deposits to individual and joint accounts for the purposes of this provision.
- ▶ d. If the customer deposits a \$500 local check and gets \$225 cash back at the time of deposit, the bank need not make an additional \$225 available for withdrawal on the following day. Similarly, if the customer depositing the local check has a negative book balance, or negative available balance in its account at the time of deposit, the \$225 that must be available on the next business day may be made available by applying the \$225 to the negative balance, rather than making the \$225 available for withdrawal by cash or check on the following day. paragraph 7 is added, to read: 7. Dollar Amount Adjustment—See section 229.11 for the rules regarding adjustments for inflation every five years to the dollar amounts used in this section.

Sec. 229.10 - Next-day availability Cont.

- ▶ Beginning July 1, 2020, the \$100 amount in this paragraph is subject to adjustment for inflation every five years. See § 229.11 for current values.
- ▶ (c) Certain check deposits--
- ▶ (1) General rule. A depository bank shall make funds deposited in an account by check available for withdrawal not later than the business day after the banking day on which the funds are deposited, in the case of--
- ▶ (i) A check drawn on the Treasury of the United States and deposited in an account held by a payee of the check;
- ▶ (ii) A U.S. Postal Service money order deposited--
- ▶ (A) In an account held by a payee of the money order; and
- ▶ (B) In person to an employee of the depository bank.
- ▶ (iii) A check drawn on a Federal Reserve Bank or Federal Home Loan Bank and deposited--
- ▶ (A) In an account held by a payee of the check; and
- ▶ (B) In person to an employee of the depository bank;

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Sec. 229.10 - Next-day availability Cont.

- ▶ (iv) A check drawn by a state or a unit of general local government and deposited--
- ▶ (A) In an account held by a payee of the check;
- ▶ (B) In a depository bank located in the state that issued the check, or the same state as the unit of general local government that issued the check;
- ▶ (C) In person to an employee of the depository bank; and
- ▶ (D) With a special deposit slip or deposit envelope, if such slip or envelope is required by the depository bank under paragraph (c)(3) of this section.
- ▶ (v) A cashier's, certified, or teller's check deposited--
- ▶ (A) In an account held by a payee of the check;
- ▶ (B) In person to an employee of the depository bank; and
- ▶ (C) With a special deposit slip or deposit envelope, if such slip or envelope is required by the depository bank under paragraph (c)(3) of this section.
- ▶ (vi) A check deposited in a branch of the depository bank and drawn on the same or another branch of the same bank if both branches are located in the same state or the same check processing region; and,
- ▶ (vii) The lesser of--(A) \$100, or (B) The aggregate amount deposited on any one banking day to all accounts of the customer by check or checks not subject to next-day availability under paragraphs (c)(1) (i) through (vi) of this section.
- ▶ D. 229.10(c) Certain Check Deposits For all new accounts, even if the new account exception is not invoked, traveler's checks must be included in the \$5,000 [effective 7/1/2020, \$5,525] aggregation of checks deposited on any one banking day that are subject to the next-day availability requirement. (See §229.13(a).)

Sec. 229.11 - Adjustment of dollar amounts

- ▶ This section is added, effective July 1, 2020.
- ▶ (a) Dollar amounts indexed. The dollar amounts specified in §§ 229.10(c)(1)(vii), 229.12(d), 229.13(a), 229.13(b), 229.13(d), and 229.21(a) shall be adjusted effective on July 1, 2020, on July 1, 2025, and on July 1 of every fifth year after 2025, in accordance with the procedure set forth in paragraph (b) of this section using the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W), as published by the Bureau of Labor Statistics.
- ▶ (b) Indexing procedure—
- ▶ (1) Inflation measurement periods. For dollar amount adjustments that are effective on July 1, 2020, the inflation measurement period begins in July 2011 and ends in July 2018. For dollar amount adjustments that are effective on July 1, 2025, the inflation measurement period begins in July 2018 and ends in July 2023. For dollar amount adjustments that are effective on July 1 of every fifth year after 2025, the inflation measurement period begins in July of every fifth year after 2018 and ends in July of every fifth year after 2023. Following each inflation measurement period, the dollar amount adjustments will be published in the Federal Register.
- ▶ (2) Percentage change. Any dollar amount adjustment under this section shall be calculated across an inflation measurement period by the aggregate percentage change in the CPI-W, including both positive and negative percentage changes. The aggregate percentage change over the inflation measurement period will be rounded to one decimal place, using the CPI-W value for July (which is generally released by the Bureau of Labor Statistics in August).

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Sec. 229.11- Adjustment of dollar amounts: Cont.

- ▶ (3) Adjustment amount. The adjustment amount for each dollar amount listed in paragraph (a) of this section shall be equal to the aggregate percentage change multiplied by the existing dollar amount listed in paragraph (c) of this section and rounded to the nearest multiple of \$25. The adjusted dollar amount will be equal to the sum of the existing dollar amount and the adjustment amount. No dollar adjustment will be made when the aggregate percentage change is zero or a negative percentage change, or when the aggregate percentage change multiplied by the existing dollar amount listed in paragraph (c) and rounded to the nearest multiple of \$25 results in no change.
- ▶ (4) Carry-forward. When there is an aggregate negative percentage change over an inflation measurement period, or when an aggregate positive percentage change over an inflation measurement period multiplied by the existing dollar amount listed in paragraph (c) of this section and rounded to the nearest multiple of \$25 results in no change, the aggregate percentage change over the inflation measurement period will be included in the calculation to determine the percentage change at the end of the subsequent inflation measurement period. That is, the cumulative change in the CPI-W over the two (or more) inflation measurement periods will be used in the calculation until the cumulative change results in publication of an adjusted dollar amount in the regulation.

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Sec. 229.11 - Adjustment of dollar amounts: Cont.

- ▶ This section is added, effective July 1, 2020.
- ▶ (c) Amounts. (1) For purposes of § 229.10(c)(1)(vii), the dollar amount in effect during a particular period is the amount stated in this paragraph (c)(1) for that period.
 - ▶ (i) Prior to July 21, 2011, the amount is \$100.
 - ▶ (ii) From July 21, 2011, through June 30, 2020, by operation of section 603(a)(2)(D) of the EFA Act (12 U.S.C. 4002(a)(2)(D)) the amount is \$200.
 - ▶ (iii) Effective July 1, 2020, the amount is \$225.
- ▶ (2) For purposes of § 229.12(d), the dollar amount in effect during a particular period is the amount stated in this paragraph (c)(2) for that period.
 - ▶ (i) Prior to July 1, 2020, the amount is \$400.
 - ▶ (ii) Effective July 1, 2020, the amount is \$450.
- ▶ (3) For purposes of § 229.13(a), (b), and (d), the dollar amount in effect during a particular period is the amount stated in this paragraph (c)(3) for that period.
 - ▶ (i) Prior to July 1, 2020, the amount is \$5,000.
 - ▶ (ii) Effective July 1, 2020, the amount is \$5,525.
- ▶ (4) For purposes of § 229.21(a), the dollar amounts in effect during a particular period are the amounts stated in this paragraph (c)(4) for the period.
 - ▶ (i) Prior to July 1, 2020, the amounts are \$100, \$, and \$500,000 respectively.
 - ▶ (ii) Effective July 1, 2020, the amounts are \$100, \$1,100, and \$552,500 respectively.

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Sec. 229.12 - Availability schedule

- ▶ **CAVEAT:** References in this section to nonlocal checks are no longer effective. Nonlocal checks, by definition, ceased to exist when the Federal Reserve System finished its consolidation of check processing regions to a single region in 2010.
- ▶ para. 4 is added, to read:
- ▶ 4. Dollar Amount Adjustment—See section 229.11 for the rules regarding adjustments for inflation every five years to the dollar amounts in this section.
- ▶ paragraphs 1 and 2 are revised, to read:
- ▶ The EFA Act and regulation provide an extension of the availability schedules for Star Printed Page 31698 check deposits at a branch of a bank if the branch is located in Alaska, Hawaii, Puerto Rico, American Samoa, the Commonwealth of the Northern Mariana Islands, Guam, or the U.S. Virgin Islands. The schedules for local checks, nonlocal checks (including nonlocal checks subject to the reduced schedules of appendix B), and deposits at nonproprietary ATMs are extended by one business day for checks deposited to accounts in banks located in these jurisdictions that are drawn on or payable at or through a paying bank not located in the same jurisdiction as the depository bank. For example, a check deposited in a bank in Hawaii and drawn on a San Francisco paying bank must be made available for withdrawal not later than the third business day following deposit. This extension does not apply to deposits that must be made available for withdrawal on the next business day.

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Sec. 229.20 - Relation to state law

- ▶ Paragraph 2 is revised to read:
- ▶ 2. Under a state law, some categories of deposits could be available for withdrawal sooner or later than the time required by this subpart, depending on the composition of the deposit. For example, the EFA Act and this regulation (§ 229.10(c)(1)(vii)) require next-day availability for the first \$225 of the aggregate deposit of local or nonlocal checks on any day, and a state law could require next-day availability for any check of \$200 or less that is deposited. Under the EFA Act and this regulation, if either one \$300 check or three \$100 checks are deposited on a given day, \$225 must be made available for withdrawal on the next business day, and \$75 must be made available in accordance with the local or nonlocal schedule. Under the state law, however, the two deposits would be subject to different availability rules. In the first case, none of the proceeds of the deposit would be subject to next-day availability; in the second case, the entire proceeds of the deposit would be subject to next-day availability. In this example, because the state law would, in some situations, permit a hold longer than the maximum permitted by the EFA Act, this provision of state law is inconsistent and preempted in its entirety.

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Sec. 229.21 - Civil liability

- ▶ (a) Civil liability. A bank that fails to comply with any requirement imposed under subpart B, and in connection therewith, subpart A, of this part or any provision of state law that supersedes any provision of subpart B, and in connection therewith, subpart A, with respect to any person is liable to that person in an amount equal to the sum of--
 - ▶ (1) Any actual damage sustained by that person as a result of the failure;
 - ▶ (2) Such additional amount as the court may allow, except that--
 - ▶ (i) In the case of an individual action, liability under this paragraph shall not be less than \$100 [effective 7/1/2020, \$225] nor greater than \$1,000; and
 - ▶ (ii) In the case of a class action--
 - ▶ (A) No minimum recovery shall be applicable to each member of the class; and
 - ▶ (B) The total recovery under this paragraph in any class action or series of class actions arising out of the same failure to comply by the same depository bank shall not be more than the less
- ▶ Paragraph 2 is added, to read: 2. Dollar Amount Adjustment—See section 229.11 for the rules regarding adjustments for inflation every five years to the dollar amounts in this section.