

Proposed Rules

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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

FEDERAL RESERVE SYSTEM

12 CFR Parts 210 and 229

[Regulations J and CC; Docket No. R-1226]

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

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule.

SUMMARY: The Board of Governors is requesting comment on proposed amendments to Regulation CC that would define “remotely created checks” and create transfer and presentment warranties for such checks. The purpose of the amendments is to shift liability for unauthorized remotely created checks to the depository bank, which is generally the bank for the person that initially created and deposited the remotely created check. The Board is also proposing conforming cross-references to the proposed new warranties in Regulation J.

DATES: Comments on the proposed rule must be received not later than May 3, 2005.

ADDRESSES: You may submit comments, identified by Docket No. R-1226, by any of the following methods:

- Agency Web site: <http://www.federalreserve.gov>. Follow the instructions for submitting comments at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm>.
- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- E-mail: regs.comments@federalreserve.gov. Include docket number in the subject line of the message.
- FAX: 202/452-3819 or 202/452-3102.

- Mail: Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551.

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

FOR FURTHER INFORMATION CONTACT:

Adrienne G. Threatt, Counsel (202/452-3554), or Joshua H. Kaplan, Attorney, (202/452-2249), Legal Division; or 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; for users of Telecommunication Devices for the Deaf (TDD) only, contact 202/263-4869.

SUPPLEMENTARY INFORMATION:

Background

“Remotely created checks” typically are created when the holder of a checking account authorizes a payee to draw a check on that account but does not actually sign the check.¹ In place of the signature of the account-holder, the remotely created check generally bears a statement that the customer authorized the check or bears the customer's printed or typed name. Remotely created checks can be useful payment devices. For example, a debtor can authorize a credit card company to create a remotely created check by telephone. This may enable the debtor to pay his credit card bill in a timely manner and avoid late charges. Similarly, a person who does not have a credit card or debit card can purchase an item from a telemarketer by authorizing the seller to create a remotely created check.

On the other hand, remotely created checks are vulnerable to fraud because they do not bear a signature or other readily verifiable indication of authorization. Because remotely created checks are cleared in the same manner

as other checks, it is difficult to measure the use of remotely created checks relative to other types of checks. However, there have been significant consumer and bank complaints identifying cases of alleged fraud using remotely created checks.

Existing Law on Remotely Created Checks

A remotely created check is subject to state law on negotiable instruments, specifically Articles 3 and 4 of the Uniform Commercial Code (U.C.C.) as adopted in each state. Under the U.C.C., a paying bank may charge a customer's account for a check only if the check is properly payable. A bank generally must recredit its customer's account for the amount of any unauthorized check it pays.² This obligation is subject to limited defenses.³ In addition, the paying bank may have evidence that the depositor did in fact authorize the check and is suffering buyer's remorse and thus does not have to recredit the amount of the check.⁴

A paying bank may, until midnight of the banking day after a check has been presented to the bank, return the check to the depository bank if, among other things, the paying bank believes the check is unauthorized. Once its midnight deadline has passed, the paying bank generally cannot return an unauthorized check to the depository bank.⁵

The provisions of the U.C.C., cited above, reflect the rule set forth in the seminal case of *Price v. Neal*⁶ that drawees of checks and other drafts must bear the economic loss when the

² U.C.C. 4-401.

³ For example, the paying bank may be able to assert that the customer failed to notify the bank of the unauthorized item with “reasonable promptness” (U.C.C. 4-406(c) and (d)).

⁴ The FTC's Telemarketing Sales Rule prohibits a telemarketer from issuing a remotely created check on a consumer's deposit account without the consumer's express verifiable authorization. The authorization is deemed verifiable if it is in writing, tape recorded and made available to the consumer's bank upon request, or confirmed by a writing sent to the consumer prior to submitting the check for payment. 6 CFR part 310.

⁵ See U.C.C. 4-301 and 4-302. In limited cases, the paying bank may be able to recover from the presenting bank the amount of a check that it paid under the mistaken belief that the signature of the drawer of the draft was authorized. This remedy, however, may not be asserted against a person that took the check in good faith and for value or that in good faith changed position in reliance on the payment or acceptance. U.C.C. 3-418(a) and (c).

⁶ 97 Eng. Rep. 871 (K.B. 1762).

¹ There is no settled term for these items. The terms “remotely created check,” “telecheck,” “preauthorized drafts,” and “paper draft” are among the terms that describe these items. For purposes of this proposal, the Board refers to these items as “remotely created checks.”

instruments they pay are not properly payable by virtue of the fact that the drawer did not authorize the item.⁷ Under the *Price v. Neal* rule, the paying bank must bear the economic loss of an unauthorized check with little recourse other than bringing an action against the person that created the unauthorized item. This rule currently applies to all checks, including remotely created checks, in most states.

The *Price v. Neal* rule reflects the policy that the paying bank, rather than the depository bank, is in the best position to judge whether the signature on a check is the authorized signature of its customer. Remotely created checks, however, do not bear a handwritten signature of the drawer that can be verified against a signature card. In most cases, the only means a paying bank would have to verify a remotely created check (and return it if it is unauthorized) is by contacting the customer before the midnight deadline passes. Even if a paying bank wished to verify the authenticity of remotely created checks, however, it must first identify remotely created checks drawn on its accounts. Currently, there is no code or feature of a remotely created check that allows this to be done reliably in an automated manner. For example, remotely created checks bear no machine-readable identifiers that indicate they are remotely created checks.

Recent Legal Changes To Address Remotely Created Checks

Amendments to the U.C.C.

In recognition of the particular problems regarding remotely created checks, the National Conference of Commissioners on Uniform State Laws and the American Law Institute in 2002 approved revisions to Articles 3 and 4 of the U.C.C. that specifically address remotely created checks. The U.C.C. revisions define a remotely created check (using the term "remotely-created consumer item") as "an item drawn on a consumer account, which is not created by the paying bank and does not bear a hand written signature purporting to be the signature of the drawer."⁸ The U.C.C. revisions require a person that transfers a remotely-created consumer item to warrant that the person on whose account the item is drawn authorized the issuance of the item in the amount for which the item is drawn.⁹ Accordingly, in the case of

remotely-created consumer items the U.C.C. alters the *Price v. Neal* rule to provide that the depository bank and each intermediary bank warrants to the paying bank that the remotely-created consumer item is authorized.¹⁰

These revisions rest on the premise that it is appropriate to impose the burden of ensuring authorization of a remotely created check on the bank whose customer deposited the remotely created check.¹¹ The warranty provides an economic incentive for the depository bank to monitor customers that deposit remotely created checks and should have the effect of limiting the quantity of unauthorized remotely created checks that are introduced into the check collection system.

Amendments to State Laws

Fourteen states have amended their Articles 3 and 4 to include provisions similar to those in the U.C.C.¹² No state, however, has adopted the U.C.C. revisions in their entirety and the revisions adopted by the states are not uniform in their scope or requirements. In addition to the state codes, some check clearinghouses have adopted warranties similar but not identical to the revised U.C.C. that apply to remotely created checks collected through the clearinghouse.

For example, in California, a person that transfers a remotely created check warrants to the transferee that "creation of the item according to the terms on its face was authorized by the person identified as the drawer."¹³ The California Commercial Code defines a remotely created check as follows: a writing not signed by a customer that is created by a third party under the purported authority of the customer for the purpose of charging the customer's account with a bank. A remotely created check shall contain the customer's account number and may contain any or all of the following:

- (1) The customer's printed or typewritten name.
- (2) A notation that the customer authorized the draft.

transferee and, if the transfer is by indorsement, to any subsequent transferee with respect to a remotely-created consumer item, that the person on whose account the item is drawn authorized the issuance of the item in the amount for which the item is drawn. See also U.C.C. 4-207(a)(6), 3-417(a)(4), 4-208(a)(4).

¹⁰ Normally, the transferor must warrant only that it has "no knowledge" that the instrument is unauthorized. U.C.C. 3-417(a)(3).

¹¹ U.C.C. 3-416, Official Comment, paragraph 8. The Official Comment notes that the provision supplements FTC's Telemarketing Rule, which requires telemarketers to obtain the customer's "express verifiable authorization."

¹² Those states are California, Colorado, Hawaii, Idaho, Minnesota, Nebraska, New Hampshire, North Dakota, Oregon, Tennessee, Utah, Vermont, West Virginia, and Wisconsin.

¹³ Cal. U. Com. Code § 3416 (2004).

(3) The statement "No Signature Required" or words to that effect.

A remotely created check shall not include a check purportedly drawn by and bearing the signature of a fiduciary. * * *

Several states use the same warranty language as California, although they define a remotely created check slightly differently, omitting the California statute's requirement that a remotely created check contain the customer's account number. Vermont generally follows the California language; however, Vermont law includes an exception to account for conflict of law rules.¹⁴

The state-by-state approach to the adoption of remotely created check warranties complicates the trail of liability for remotely created checks collected across state lines, as the bank that presents a check may not be subject to the same rules as the paying bank.

Proposed Rule

The Expedited Funds Availability Act (the EFA Act), Pub. L. 100-86, 101 Stat. 635 (codified at 12 U.C.C. 4001 *et seq.*), authorizes the Board to establish rules regarding losses and liability among depository institutions "in connection with any aspect of the payment system."¹⁵ As noted above, the check collection and return system operates nationally. As a result, in order for the remotely created check warranties to be effective and to prevent conflicts among warranties as they apply to banks, the warranties must apply uniformly and nationwide. In connection with its proposed amendments to Regulation CC to implement the Check Clearing for the 21st Century Act (the Check 21 Act), the Board requested comment on whether it should develop a proposal to amend Regulation CC to adopt the U.C.C. warranties for remotely created checks.¹⁶ Seventy-six commenters responded to the Board's request for comment on this issue, and all but two supported the proposal,¹⁷ including the

¹⁴ 9A V.S.A. § 3-416(e).

¹⁵ The Board is authorized to impose on or allocate among depository institutions the risks of loss and liability in connection with any aspect of the payment system, including the receipt, payment, collection, or clearing of checks, and any related function of the payment system with respect to checks. Such liability may not exceed the amount of the check giving rise to the loss or liability, and, where there is bad faith, other damages, if any, suffered as a proximate consequence of any act or omission giving rise to the loss or liability. 12 U.S.C. 4010(f).

¹⁶ 69 FR 1470, 1482, Jan. 8, 2004.

¹⁷ One commenter argued that it would be inappropriate for the Board to adopt the U.C.C. warranty for remotely created checks because it has not yet been adopted by all states. The other commenter stated that it is neither in favor nor opposed to incorporating the U.C.C. warranty but is

⁷ See also *Interbank of New York v. Fleet Bank*, 730 NYS2d 208 (2001).

⁸ U.C.C. 3-103(16).

⁹ U.C.C. 3-416(a). A person who transfers an instrument for consideration warrants to the

Permanent Editorial Board for the U.C.C.¹⁸ In publishing the final amendments to Regulation CC to implement the Check 21 Act, the Board noted its intent to issue a separate proposal regarding remotely created checks.¹⁹

The Board's proposal defines "remotely created check" as a check that is drawn on a customer account at a bank, is created by the payee, and does not bear a signature in the format agreed to by the paying bank and the customer. This definition would include checks that are created by remote payees or their agents to enable payors to make a payment by check.²⁰

Unlike the U.C.C. amendments, the Board's proposed definition would apply to remotely created checks drawn on either a consumer or a non-consumer account. Although most remotely created checks are believed to be drawn on consumer accounts, these checks could be drawn on business or other accounts as well. In either case, the depository bank would appear in the best position to address the potential for fraudulent check writing.

A remotely created check often contains a statement that the customer authorized the check, the customer's printed or typed name, or a similar notation. Generally, a paying bank and its customer agree to a form of authorization for checks drawn on the customer's account. These agreed-upon formats most often take the form of a handwritten signature or a specific type of machine-applied signature. The proposed definition covers remotely created checks that do not bear a signature in the format agreed to between the paying bank and its customer. Accordingly, a check that is created by someone other than the drawer and on which the drawer's signature is applied using the authorization format agreed to by the paying bank and its customer (such as a handwritten signature), is not a

unsure how such a warranty in Regulation CC would be enforced.

¹⁸ The Permanent Editorial Board for the U.C.C. stated that the lack of uniform state law "creates a problem that a remotely-created-items warranty in Regulation CC would resolve. Under the existing non-uniform state of play, a company creating large numbers of these items could avoid the new uniform [U.C.C.] transfer and presentment warranties and continue to insulate itself and its depository banks by selecting depository banks in states that have not adopted these warranties."

¹⁹ 69 FR 47290, 47306, Aug. 4, 2004.

²⁰ The proposed Commentary would provide that a check created by the payee's agent would be deemed to be created by the payee. Therefore, if a telemarketer hired a service provider to create checks drawn on the accounts of the telemarketer's customers, those checks would be covered by the definition.

remotely created check under the proposal. For example, a typical forged check, such as a stolen personal check fraudulently signed by a person other than the drawer, is not covered by the proposed definition of a remotely created check. In this regard, the existing system of warranties appears suitable for those types of situations because the paying bank can monitor the format and the signatures it has agreed to with its customer.

The Board proposes to create transfer and presentment warranties that would apply to remotely created checks that are transferred or presented by banks to other banks. Under the proposed warranties, any transferor bank, collecting bank, or presenting bank would warrant that the remotely created check that it is transferring or presenting is authorized according to all of its terms by the person on whose account the check is drawn. The proposed warranties would apply only to banks and would ultimately shift liability for the loss created by an unauthorized remotely created check to the depository bank. A paying bank would not be able to assert a warranty claim under the Board's proposed rule directly against a nonbank payee that created or transferred an unauthorized remotely created check. The proposed transfer and presentment warranties differ in this respect from the U.C.C. provisions, which apply to any person that transfers a remotely created check. However, the bank would likely have a claim under other law against such a payee. The Board's proposal also differs from the U.C.C. provisions to the extent that the Board's proposed warranties cover all of the terms of the check while the U.C.C. provisions cover only authorization of the issuance of the check in the amount for which the check is drawn. The Board is also proposing conforming cross-references to the proposed new warranties in Regulation J.

The Board requests comment on all aspects of the proposed definition of a remotely created check and the scope of the proposed transfer and presentment warranty. In particular, the Board requests comment on how best to distinguish remotely created checks, to which the proposed warranty would apply, from other fraudulent checks, which would not be subject to the proposed warranty. The proposed definition of remotely created check attempts to make this distinction by stating that the check "does not bear a signature in the format agreed to by the paying bank and the customer." A payee that creates an unauthorized remotely created check could circumvent this requirement, however, by applying a

handwritten signature purporting to be the signature of a consumer. Similarly, a traditional forged check that contains a signature in a different format than that agreed to by the paying bank and the customer could be subject to the proposed warranty.

There are few statistics or other quantitative data on remotely created checks; therefore, the Board also seeks comment on the prevalence and uses of remotely created checks generally. The Board also requests comment on the general characteristics of remotely created checks, including the manner by which such checks typically reflect the account-holder's authorization. In addition, the Board invites comment on whether it is appropriate to cover all remotely created checks or to follow the U.C.C. approach of covering only remotely-created consumer items.

Additional Requests for Comment

There are other approaches to addressing the risks associated with remotely created checks. The Board invites comment on whether a different approach to addressing this issue is more appropriate. In particular, the Board requests comment on two alternatives.

Extension of the Midnight Deadline

Under the proposal described above, a paying bank would recover its losses caused by an unauthorized remotely created check by making a warranty claim outside of the check collection and return system. As an alternative, the rule could potentially allow such a paying bank to return the unauthorized remotely created check through the check system by extending the U.C.C. midnight deadline for a period of time (such as 60 days). Such a rule could reduce the cost of recovering losses suffered in paying unauthorized remotely created checks and is similar to the return scheme for unauthorized ACH transactions. However, the rule would extend the midnight deadline considerably, and thereby delay finality of payment and discharge of the underlying obligation with respect to remotely created checks. Commenters that favor the extension of the midnight deadline are encouraged to explain their preference for this approach, including how such an approach would be implemented under the current check collection process.

Allow the State Legislatures To Adopt the U.C.C. Amendments

The Board could refrain from or delay acting on the remotely created check issue and allow the states to adopt the U.C.C. warranty, or some variation

thereof, on their own. Check law traditionally has been the province of state law, although a substantial number of Federal laws and regulations apply to the check collection system as well. The pace at which the states have adopted the U.C.C. changes has been slow and that might be an indication that consensus has not been reached on whether there should be a change to the warranties for remotely created checks.

MICR Line Identifier

Regardless of whether the Board provides a special warranty or return rule for remotely created checks, it may be useful to have a means of identifying these checks so that banks can better protect themselves and their customers against fraud. Identifying remotely created checks could be accomplished by assigning digits in the External Processing Code (EPC) Field (commonly referred to as Position 44) of the MICR line to remotely created checks. Four digits would appear to be necessary to identify a forward and return original remotely created check and a substitute check version.

The practical utility of a MICR line code for identifying fraudulent checks may be low in practice, however, because a person depositing an unauthorized remotely created check would be unlikely to place an EPC identifier in the MICR line. Furthermore, requiring a payee, rather than a bank, to encode in position 44 of the MICR line may lead to inconsistent results and operational problems.

Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.C.C. 3506; 5 CFR part 1320 Appendix A.1), the Board has reviewed the proposed rule under authority delegated to the Board by the Office of Management and Budget. The proposed rule contains one collection of information pursuant to the Paperwork Reduction Act. In addition to the proposed rule, the Board requests comment on whether banks should be required to ensure that a remotely created check includes identifying digits in the MICR line. The MICR line requirement would be deemed a collection of information, however, the Board believes that the paperwork burden associated with such a requirement would be minimal. The Board invites comment on the paperwork burden associated with the MICR line requirement.

Regulatory Flexibility Act

In accordance with the Regulatory Flexibility Act (RFA), an agency must publish an initial regulatory flexibility

analysis with its proposed rule, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. (5 U.C.C. 601–612.) The Board believes that, if adopted as proposed, the rule would not have a significant economic impact on a substantial number of small entities.

The RFA requires agencies to examine the objectives, costs and other economic implications on the entities affected by the rule. (5 U.C.C. 603.) Under section 3 of the Small Business Act, as implemented at 13 CFR part 121, subpart A, a bank is considered a “small entity” or “small bank” if it has \$150 million or less in assets. Based on December 2004 call report data, the Board estimates that there are approximately 13,666 depository institutions with assets of \$150 million or less. The proposed amendments to Regulation CC create a definition of a remotely created check and warranties that apply when a remotely created check is transferred or presented. The proposed amendments would require any bank that transfers or presents a remotely created check to warrant that the person on whose account the remotely created check is drawn authorized the issuance of the check according to the terms stated on the check. The purpose of the proposed amendments is to place the liability for an unauthorized remotely created check on the bank that is in the best position to prevent the loss. By shifting the liability to the bank in the best position to prevent the loss caused by the payment of an unauthorized remotely created check, the Board anticipates that the proposed amendments will reduce costs for all banks that handle remotely created checks. Banks seeking to minimize the risk of liability for transferring remotely created checks will likely screen with greater scrutiny customers seeking to deposit remotely created checks. The Board believes that the controls that small institutions will develop and implement to minimize the risk of accepting unauthorized remotely created checks for deposit likely would pose a minimal negative economic impact on those entities. The Board invites comment on the economic impact of the proposed warranties on small institutions.

The RFA requires agencies to identify all relevant Federal rules which may duplicate, overlap or conflict with the proposed rule. As noted above, the Board’s Regulation J includes cross-references to the warranties set forth in Regulation CC and the proposed rule would amend such cross-references to include the proposed warranties. As

also noted above, the proposed rule would overlap with 14 state codes which presently provide warranties for remotely created checks. The RFA also requires agencies to describe any significant alternatives to the proposed rule. The alternatives are discussed above and comment is requested on the proposed alternatives.

List of Subjects in 12 CFR Parts 210 and 229

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

Authority and Issuance

For the reasons set forth in the preamble, the Board is proposing to amend parts 210 and 229 of chapter II of title 12 of the Code of Federal Regulations as set forth below:

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

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

Authority: 12 U.S.C. 248(i) and (j), 12 U.S.C. 342, 12 U.S.C. 464, 12 U.S.C. 4001 *et seq.*, 12 U.S.C. 5001–5018.

2. In § 210.5, revise paragraph (a)(3) to read as follows:

§ 210.5 Sender’s agreement; recovery by Reserve Bank.

(a) * * *
* * * * *

(3) *Warranties for all electronic items.* The sender makes all the warranties set forth in and subject to the terms of 4–207 of the U.C.C. for an electronic item as if it were an item subject to the U.C.C. and makes the warranties set forth in and subject to the terms of § 229.34(c) and (d) of this chapter for an electronic item as if it were a check subject to that section.

* * * * *

3. In § 210.6, revise paragraph (b)(2) to read as follows:

§ 210.6 Status, warranties, and liability of Reserve Bank.

* * * * *

(b) * * *

(2) *Warranties for all electronic items.* The Reserve Bank makes all the warranties set forth in and subject to the terms of 4–207 of the U.C.C. for an electronic item as if it were an item subject to the U.C.C. and makes the warranties set forth in and subject to the terms of § 229.34(c) and (d) of this

chapter for an electronic item as if it were a check subject to that section.

* * * * *

4. In § 210.9, revise paragraph (b)(5) to read as follows:

§ 210.9 Settlement and payment.

* * * * *

(b) * * *

(5) *Manner of settlement.* Settlement with a Reserve Bank under paragraphs (b)(1) through (4) of this section shall be made by debit to an account on the Reserve Bank's books, cash, or other form of settlement to which the Reserve Bank agrees, except that the Reserve Bank may, in its discretion, obtain settlement by charging the paying bank's account. A paying bank may not set off against the amount of a settlement under this section the amount of a claim with respect to another cash item, cash letter, or other claim under section 229.34(c) and (d) of this chapter (Regulation CC) or other law.

* * * * *

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

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

Authority: 12 U.S.C. 4001 *et seq.*, 12 U.S.C. 5001–5018.

6. In § 229.2, add a new paragraph (fff) to read as follows:

§ 229.2 Definitions.

* * * * *

(fff) *Remotely created check* means a check that is drawn on a customer account at a bank, is created by the payee, and does not bear a signature in the format agreed to by the paying bank and the customer.

7. In § 229.34, redesignate paragraphs (d), (e), and (f) as paragraphs (e), (f), and (g), and add a new paragraph (d) to read as follows:

§ 229.34 Warranties.

* * * * *

(d) *Transfer and presentment warranties with respect to a remotely created check.*

A bank that transfers or presents a remotely created check and receives a settlement or other consideration warrants to the transferee bank, any subsequent collecting bank, and the paying bank that the person on whose account the remotely created check is drawn authorized the issuance of the check according to the terms stated on the check.

* * * * *

8. In § 229.43, revise paragraph (b)(3) to read as follows:

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

* * * * *

(b) *Rules applicable to Pacific islands checks.* * * *

* * * * *

(3) § 229.34(c)(2), (c)(3), (d), (e), and (f);

* * * * *

9. In Appendix E to part 229:

a. Under paragraph II., § 229.2, paragraph (OO) is revised and a new paragraph (FFF) is added.

b. Under paragraph XX., § 229.34, redesignate paragraphs D., E., and F. as paragraphs E., F., and G., and add a new paragraph D.

APPENDIX E TO PART 229—COMMENTARY

* * * * *

II. Section 229.2 Definitions

* * * * *

OO. 229.2(o) Interest Compensation

1. This calculation of *interest compensation* derives from U.C.C. 4A–506(b). (See §§ 229.34(e) and 229.36(f).)

* * * * *

FFF. 229.2(fff) Remotely Created Check

1. A remotely created check may be drawn on a consumer account or an account held by a corporation, unincorporated company, partnership, government unit or instrumentality, trust, or any other entity or organization. In accordance with principles of the law of agency, an agent of a payee is deemed to be the payee for purposes of the definition of remotely created checks.

2. A check authorized by a consumer over the telephone, which is created by the payee, and which bears a legend on the signature line such as “Authorized by Drawer” is an example of a remotely created check. A check that bears the signature of the customer or a signature purporting to be the signature of the customer in the format agreed to by the paying bank and the customer is not a remotely created check. For example, the agreed-upon format is often a handwritten signature, or in the case of corporate checks, a machine-applied signature. In these cases, a check that bears a handwritten or machine-applied signature (regardless of whether the signature was authentic) would not be a remotely created check. A typical forged check, such as a stolen personal check fraudulently signed by a person other than the drawer, is not covered by the definition of a remotely created check.

3. The definition of a remotely created check includes a remotely created check that has been reconverted to a substitute check.

* * * * *

XX. Section 229.34 Warranties

* * * * *

D. 229.34(d) Transfer and Presentment Warranties

1. The transfer and presentment warranties for remotely created checks supplement the Federal Trade Commission's Telemarketing Sales Rule, which requires telemarketers that submit checks for payment to obtain the customer's “express verifiable authorization” (the authorization may be either in writing or tape recorded and must be made available upon request to the customer's bank). 16 CFR 310.3(a)(3).

2. Any transferring bank, collecting bank, or presenting bank warrants that the remotely created check that it is transferring or presenting is authorized according to all of its terms by the person on whose account the check is drawn. The warranties are given only by banks and only to subsequent banks in the collection chain. The warranties ultimately shift liability for the loss created by an unauthorized remotely created check to the depository bank. The depository bank cannot assert the transfer and presentment warranties against a depositor; however, it would likely have a claim under other laws against that person or could choose to transfer the liability by contract. The transfer and presentment warranties differ from the U.C.C. warranty provisions, which are given by any person that transfers a remotely created check including a nonbank, apply only to remotely created consumer checks, and cover authorization of the issuance of the check in the amount for which the check is drawn.

3. The transfer and presentment warranties for a remotely created check apply to a remotely created check that has been reconverted to a substitute check.

* * * * *

By order of the Board of Governors of the Federal Reserve System, February 28, 2005.

Jennifer J. Johnson,
Secretary of the Board.

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