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Part III

Federal Reserve System

12 CFR Part 229
Availability of Funds and Collection of Checks; Proposed Rule

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: Proposed rule.

SUMMARY: The Board of Governors is publishing for comment proposed amendments to Regulation CC that would add a new subpart D, with commentary, to implement the recently-enacted Check Clearing for the 21st Century Act. These proposed amendments (1) would set forth the requirements of the Act that apply to banks, (2) provide a model disclosure and model notices relating to substitute checks, and (3) set forth indorsement requirements and truncating bank and reconverting bank identification requirements for substitute checks. The proposed amendments also would clarify some existing provisions of the rule and commentary.

DATES: Comments on the proposed rule must be received by March 12, 2004.

ADDRESSES: Comments should refer to docket number R–1176 and should be addressed to Ms. Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System. Comments may be mailed to 20th Street and Constitution Avenue, NW., Washington, DC 20551; faxed to the Office of the Secretary at 202/452–3819 or 202/452–3102; or mailed electronically to *regs.comments@federalreserve.gov.* Because paper mail at the Board of Governors is subject to delay, please consider submitting your comments by fax or e-mail. Members of the public may inspect comments in accordance with the Board's Rules Regarding the Availability of Information (12 CFR part 261) in Room MP–500 of the Martin Building on weekdays between 9 a.m. and 5 p.m.

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 Adrianne 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 that presents a check for payment must present the original paper check unless the paying bank has agreed to accept presentment from the collecting bank 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 truncate checks early in the collection process and engage in broad-based electronic presentment, a collecting 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] As a result of the difficulty in obtaining the agreements necessary to present checks electronically in all cases, banks have not been able to take full advantage of the efficiencies and potential cost savings of handling checks electronically.

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] The Check 21 Act accomplishes this by authorizing the use of a new negotiable instrument called a substitute check. A substitute check is a paper reproduction of an original check that contains an image of the front and back of the original check and is suitable for automated processing in the same manner as the original check. A bank that for consideration transfers, presents, or returns a substitute check (or another 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 depositary bank, drawee, drawer, or indorser will be asked to pay a check that it already has paid. A substitute check for which a bank has made these warranties is the legal equivalent of the original check for all purposes and all persons.

Allowing a substitute check that is subject to the substitute check warranties to be the legal equivalent of an original check should facilitate the use of electronics in the check collection process. For example, a depositary bank in California that receives a check drawn on a bank in New York now must present the original paper check for payment absent an agreement to the contrary, even if the California bank has agreements to collect checks electronically with other banks in the collection chain for that check. 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 accept 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.

The Check 21 Act does not require any bank to use electronic check processing, receive electronic presentment, or create substitute checks, nor would the Check 21 Act make electronic check images or electronic check information the legal equivalent of original checks. However, after the effective date of the Check 21 Act, any bank or other person that requires an original check must accept a legally equivalent substitute check in satisfaction of that requirement. The characteristics of a substitute check are such that a bank that receives 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, for the most part, banks would not be required to change their check processing equipment or practices because of the Check 21 Act, and there would be no need for a bank to sort original checks and substitute checks separately during the check collection process.[4]

Certain provisions of the Check 21 Act will affect all banks, even those that do not choose to create substitute

[1] *See, e.g.,* section 3–501(b) of the Uniform Commercial Code.

[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.

[4] However, as described in more detail in the section-by-section analysis, a bank must place a ''5'' in position 44 of the MICR line of a qualified returned substitute check, as opposed to a ''2'' that is required in that position for a qualified returned original check.

checks. For example, a bank that simply received a substitute check created by another bank, or a paper or electronic representation of a substitute check, would make the substitute check warranties when it delivered that item for presentment, collection, or return or provided that item to its customer. Any bank that receives consideration for a substitute check, or a representation of a substitute check, that it transfers, presents, or returns also is responsible for indemnifying any person that suffers a loss due to the receipt of a substitute check instead of the original check. Moreover, a bank that provides a substitute check to a consumer might be required to provide an expedited recredit to the consumer if the consumer incurred a loss due to receipt of the substitute check rather than the original check. Finally, a bank must provide a disclosure that describes substitute checks and substitute check rights to consumers who receive paid checks with their periodic account statements and consumers who receive substitute checks on a case-by-case basis.

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 caused the problem with the substitute check. In many cases this would be the first bank to transfer the substitute check (the reconverting bank).[5] A bank that paid a warranty claim or provided an indemnity or expedited recredit for a substitute check that it received from another bank therefore 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 responsible party.[6]

The Check 21 Act imposes additional duties on reconverting banks. A reconverting bank must identify itself as such on a substitute check and must preserve the indorsements of parties that previously handled the check in any form. The reconverting bank will be the first bank to provide the substitute check warranties and the first bank in the chain of indemnifying banks, and thus ultimately should bear any loss traceable to a problem that existed as of the time the substitute check was created.[7]

II. Overview of New Subpart D and Associated Amendments to Subpart A

The proposed new subpart D would incorporate into Regulation CC the requirements of the Check 21 Act that affect banks that create or receive substitute checks or paper or electronic representations of substitute checks. Subpart D therefore 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, the interaction between subpart D and existing federal and state laws, and the consumer awareness disclosure and other notices regarding substitute checks.

The proposed amendments to implement the Check 21 Act also affect some existing provisions of Regulation CC and its commentary. For example, the Board proposes to amend the authority and scope section, § 229.1, to acknowledge the Check 21 Act as an authority source and to describe subpart D. The Board also proposes to supplement some existing defined terms in § 229.2 for which the Check 21 Act has slightly different definitions and to define several new terms used in subpart D. The Board also proposes 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.

III. Other Amendments to Existing Provisions

The Board also proposes revisions to several other provisions of Regulation CC and its commentary. These changes generally either respond to enquiries that Board staff has received or respond to changed circumstances affecting the relevant provision. For example, the Board proposes 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 required by Regulation CC, and clarify the time by which a paying bank may extend the return or notice of nonpayment deadline.

Section-by-Section Analysis

The section-by-section analysis discusses the proposed commentary to each section in the course of discussing the proposed regulatory text.

I. Amendments to Implement the Check 21 Act

A. Section 229.1 Authority and Scope

The Board proposes to amend § 229.1 to include the Check 21 Act as an additional source of authority and to describe briefly the scope of new subpart D with respect to substitute checks.

B. Section 229.2 Definitions

The Board proposes two types of amendments to this section. First, the Board proposes to amend some existing defined terms to account for differences between those definitions and the definitions required by the Check 21 Act.[8] Second, the Board proposes to define new terms used in subpart D.

1. Amendments to Existing Definitions

The Board proposes to reword the existing introductory sentence and move into that sentence the text of existing § 229.2(qq), which provides that terms not defined in § 229.2 have the meanings set forth in the U.C.C.

a. *Account.* The Check 21 Act defines the term account to mean any deposit account at a bank and therefore is much broader than the existing definition in § 229.2(a), which essentially is limited to accounts that permit frequent transfers and withdrawals. The Board therefore proposes to amend the account definition to state that the existing definition applies except for purposes of subpart D. The Board proposes a new paragraph defining the term account for purposes of subpart D and, in connection therewith, subpart A, to mean any deposit, as defined at § 204.2(a)(1)(i) of Regulation D, at a bank. The Board also proposes to amend the commentary to the account definition to incorporate these changes and to highlight that many deposits that are not accounts for purposes of subparts B and C would be accounts for purposes of subpart D.

b. *Bank.* The Check 21 Act defines bank to include all of the entities currently defined as banks by § 229.2(e), plus the United States Treasury and the United States Postal Service to the

[5] 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 a paper or electronic representation of that substitute check.

[6] Banks may further allocate liability amongst themselves as part of their agreements to handle checks electronically. A reconverting bank therefore could, by agreement, pass back some or all of its loss associated with paying a warranty or indemnity to the bank that sent the check to it electronically.

[7] *But see* footnote 6.

[8] Some terms are defined identically in existing Regulation CC and the Check 21 Act, such that no amendments are necessary.

extent that those entities act as payors. The Board proposes to amend the existing definition and its commentary to incorporate the broader definition of bank for purposes of subpart D. For internal consistency, the Board proposes substituting the phrase ''paying bank'' where the Check 21 Act used the term ''payor.''

c. *Check.* The Check 21 Act's definition of check is the same as the definition in existing § 229.2(k) that applies to subpart C. The Board proposes to amend the subpart C definition of check and its commentary to apply to both subparts C and D. The proposed commentary to this definition states that a substitute check meeting the requirements of § 229.2(zz) is a check for purposes of all provisions of Regulation CC.

d. *Forward collection.* The term forward collection is defined in § 229.2(q) to mean the process by which a bank sends a check on a cash basis to the paying bank for payment. The Check 21 Act's definition is substantively the same as the existing definition but includes a clause noting that sending a check to a collecting bank for settlement can be a component of forward collection. The Board proposes to amend the forward collection definition and commentary to include that clause.

e. *Paying bank.* The Check 21 Act's definition of paying bank essentially parallels the definition in § 229.2(z) but adds the U.S. Treasury and the U.S. Postal Service with respect to a check that is payable by one of those entities and is sent to that entity for collection. The Board therefore proposes to amend § 229.2(z) and the commentary thereto to incorporate the broader definition of paying bank in subpart D.

f. *Qualified returned check.* Although the definition of a qualified returned check in § 229.2(bb) remains unchanged by the Check 21 Act, the Board proposes to amend the commentary to that definition as it relates to the content of position 44 of the MICR line. Currently, the commentary notes that a qualified returned check should have a ''2'' in position 44. The proposed amendment would retain that requirement for original checks but, in accordance with the generally applicable industry standard for substitute checks (American National Standard Specifications for Image Replacement Documents, X9.90 (ANS X9.90)), would require a ''5'' in position 44 if the qualified returned check is a substitute check.[9] The ''5'' would ensure that the size of the image of the original check would remain constant on subsequent substitute checks.

g. *State.* The Check 21 Act defines state to include all the entities that are currently listed in § 229.2(ff), plus Guam, American Samoa, the Trust Territory of the Pacific Islands, the Northern Mariana Islands, and any other territory of the United States. The Board therefore proposes to supplement the existing definition of state by including these additional entities as states for purposes of subpart D.

2. Proposed New Definitions

a. *Claimant Bank.* The term claimant bank is used in section 8 of the Check 21 Act regarding expedited recredit claims by banks, although the statute does not define that term. The Board proposes to define the term claimant bank in § 229.2(qq) to mean a bank that submits a claim for recredit under § 229.55 of Regulation CC, which corresponds to section 8 of the statute.

b. *Collecting bank, consumer, customer, and indemnifying bank.* The Board proposes to define the terms collecting bank, consumer, customer, and indemnifying bank at § 229.2(rr), (ss), (tt), and (uu), respectively. The proposed definitions incorporate the Check 21 Act definitions with only minor grammatical variations from the statutory language.

c. *Magnetic ink character recognition (MICR) line.* The Board proposes to incorporate the Check 21 Act's definition of magnetic ink character recognition (MICR) line in § 229.2(vv). The proposed commentary would note that American National Standard Specifications for Placement and Location of MICR Printing, X9.13 (ANS X9.13) is the governing standard for MICR lines of original checks and substitute checks, and that ANS X9.90 has some additional requirements regarding the content of the MICR line of a substitute check.

d. *Original check.* The Board proposes to define the term original check in § 229.2(ww) as the first paper check that is issued with respect to a particular payment transaction. The proposed commentary to this new definition explains that the Board has defined this term in order to distinguish the original check from a substitute check and from other paper or electronic representations of a check.

e. *Person.* The Board proposes to incorporate the Check 21 Act's definition of person in § 229.2(xx).

f. *Reconverting bank.* The Board proposes to define reconverting bank in § 229.2(yy) to be (1) the bank that creates a substitute check or (2) with respect to a substitute check created by a person that is not a bank, the first bank that receives the substitute check and that transfers, presents, or returns the substitute check or, in lieu of that substitute check, the first paper or electronic representation of that substitute check. The proposed commentary to this definition provides further clarification as to when and where creation of a substitute check occurs and explains that a bank need not accept a substitute check that was created by a nonbank and that has not yet been handled by a bank, unless the bank agrees to do so. Moreover, the proposed commentary provides examples of when a bank would be a reconverting bank under the definition and notes that there could be multiple reconverting banks with respect to the same payment transaction if a check moves from electronic form to substitute check form multiple times throughout the collection and return process.

g. *Substitute check.* The Board proposes to incorporate the Check 21 Act's definition of substitute check in § 229.2(zz).

The scope of the Check 21 Act and subpart D is limited to substitute checks. To clarify the scope of the term and the subpart, the Board proposes extensive commentary on the definition of substitute check. The proposed commentary provides guidance on the meaning of a ''paper reproduction of an original check'' and clarifies that, because a substitute check by definition must be a piece of paper, an electronic check file or electronic check image that has not been printed in accordance with the substitute check definition and generally applicable industry standards is not a substitute check. The commentary also explains what information is required or permitted as part of the original check images that are contained on a substitute check.

The Board particularly requests comment on the proposed commentary to the substitute check definition that describes the various ways in which the MICR line of a substitute check can vary from the MICR line of the original check. First, the commentary notes that ANS X9.90 requires the content of position 44 of the MICR line of a substitute check to vary from that of position 44 of the original check to ensure that the check image remains constant if more than one substitute check is created to represent the same original check.

[9] ANS X9.90 was in draft form on the date that the Board approved this proposed rule. The Board expects that ANS X9.90 will be final on or before October 28, 2004.

Second, the commentary acknowledges that the original check could have an encoding error in the amount field (including a failure to encode) and that a substitute check that reproduces that error would meet the definition of a substitute check. However, the commentary notes that a reconverting bank that creates a substitute check from an original check with a misencoded amount field or a bank that handles a substitute check that perpetuates the amount encoding error may repair the MICR line to facilitate the processing of the check without changing the item's status as a substitute check. This approach would be consistent with the current industry practice of allowing a bank to repair the MICR line of an original check when the bank detects an encoding error in the amount field.

Third, the commentary notes that the MICR line of the original check could be accurate in every respect but that check imaging equipment could (1) fail to read a portion of the MICR line but note the presence of MICR information with an asterisk, (2) misread a digit in the MICR line, for example by reading an ''8'' as a ''3,'' or (3) intentionally read a space or a placeholder, such as a hyphen, to be a ''0.'' These errors collectively are referred to as MICR-read errors. To ensure that the items a bank transfers in reliance on the Check 21 Act and subpart D meet the definition of a substitute check, the commentary states that before a reconverting bank creates a substitute check it should correct all MICR-read errors.[10] The proposed commentary would clarify that an item that perpetuated a MICR-read error would not be a substitute check as defined in § 229.2(zz). However, as discussed in connection with § 229.51(c) of the proposed rule and the proposed commentary to that section, the Board proposes that, when such a noncompliant item purports to be a substitute check, the substitute check warranties, indemnity, and recredit rights would apply to that item as if it were a substitute check, even though it would not be the legal equivalent of the original check. The Board proposes this approach in order to facilitate compliance with and prevent circumvention and evasion of the Check 21 Act.

h. *Sufficient copy and copy.* The Board proposes that § 229.2(aaa) would define a sufficient copy to be a copy of an original check that accurately represents the information on the front and back of the original check as of the time of truncation or otherwise is sufficient to determine the validity of a claim. This concept first appears in section 6(d)(1) of the Check 21 Act regarding what a bank must produce to limit its liability for an indemnity claim. The concept also appears in the Check 21 Act (with minor variations) in sections 7(c)(1)(B) and 8(c)(1)(A) regarding what a bank must produce to avoid making a recredit and in section 7(f)(1)(A) regarding the content of the bank's notice regarding denial of a consumer recredit claim. To streamline the regulation and make the various sufficient copy criteria parallel throughout the rule, the rule defines sufficient copy as it is defined in the indemnity section and uses that defined term in the portions of the rule that correspond to the statutory provisions listed above. The Board proposes to define a copy to be a paper reproduction of a check.[11] The proposed commentary to these terms reiterates that an electronic check image that appears on a computer screen but has not yet been printed does not constitute a copy or a sufficient copy. The commentary also provides examples of what types of documents would constitute a sufficient copy.

i. *Transfer and consideration.* The Board proposes to define transfer and consideration at § 229.2(bbb) in a manner that supplements the U.C.C. definitions of those terms in order to make the warranty, indemnity, and legal equivalence provisions function as contemplated in the Check 21 Act.

The Check 21 Act warranties, which are a precondition for the legal equivalence of a substitute check, and the indemnity, are given when a substitute check or representation thereof is transferred, presented, or returned for consideration. Under the existing U.C.C. definitions, a bank that pays a substitute check that it later provides to the drawer or a bank that pays a check presented electronically and then creates a substitute check to give to the drawer would not be transferring the check to the drawer under the U.C.C. and arguably would not receive consideration for the substitute check from the drawer. However, the Check 21 Act explicitly provides that a drawer receives the substitute check warranties if it receives a substitute check or a paper or electronic representation of a substitute check. The Check 21 Act also provides that a drawer who suffers a loss due to the receipt of a substitute check instead of the original check receives an indemnity. These provisions indicate that the substitute check received by the drawer in the examples provided above is intended to be the legal equivalent of the original check and subject to the warranties and indemnity.

Therefore, for the limited purpose of making the warranty, indemnity, and legal equivalence sections work as intended, the proposed rule would expand the term transfer to include delivery of a substitute check (or a paper or electronic representation of a substitute check) by a bank to a person that is not a bank. The proposed rule also would expand the term consideration to include the bank's charging, having the right to charge, or otherwise receiving value for a substitute check (or a paper or electronic representation of the substitute check) that the bank transfers. However, the proposed rule would explicitly exclude from the definition of consideration the transfer of a substitute check solely in response to a claim related to that substitute check.[12] The proposed commentary to the transfer and consideration definitions provides examples of the situations the expansion is designed to capture.

j. *Truncate.* The Board proposes to incorporate the Check 21 Act's definition of truncate in § 229.2(ccc). The proposed commentary highlights that removal of a substitute check is not truncation because truncation refers only to original checks.

k. *Truncating bank.* The Board proposes to define in § 229.2(ddd) the term truncating bank, which is not used in the Check 21 Act but is used in § 229.51 and appendix D of the proposed rule. The Board proposes to define truncating bank (in a manner that parallels the definition of reconverting bank) to be the bank that truncates the original check or, if a person other than a bank truncates the check, the first bank that transfers, presents, or returns the check in a form other than the original check. The proposed commentary to this section provides an

[10] American National Standards Specifications for Electronic Exchange of Check and Image Data, X9.37, (ANS X9.37), is being amended to address the identification and repair of MICR-read errors that are indicated with asterisks. The Board expects this amendment to be finalized prior to the effective date of the Check 21 Act.

[11] As explained in the analysis of § 229.58, when a bank is required to produce an original check or a sufficient copy, the rule allows a bank to provide an electronic image of that item if the recipient has agreed to receive that information electronically.

[12] A bank should be able to produce a substitute check that does not contain the legal equivalence legend as a ''sufficient copy'' in response to an indemnity or recredit claim. However, if this were considered a transfer for consideration, the bank would be making the substitute check warranties and thus could not in good faith provide a substitute check without a legend, because by doing so it automatically would have breached the legal equivalence legend component of the legal equivalence warranty.

example of when a bank would be a truncating bank.

C. Section 229.30 Paying Bank's Responsibility for Return of Checks, and Section 229.31 Returning Bank's Responsibility for Return of Checks

The Board proposes to revise existing sentences in §§ 229.30(a)(2)(iii) and 229.31(a)(2)(iii) relating to the proper MICR-line encoding of a qualified returned check. These amendments would specify that a qualified returned substitute check must contain a ''5'' in position 44 of the MICR line, whereas a qualified returned original check must contain a ''2'' in that position. As discussed above with respect to the definition of a qualified returned check and the definition of substitute check, a substitute check must contain a different number to ensure that the image of the original check remains a constant size. The Board proposes to move the specific references to ANS X9.13 from the regulation text to the commentary of these two paragraphs and specify that this standard applies to original checks. The commentary to each paragraph also would specify that ANS X9.90 is the standard that applies to substitute checks.

D. Indorsement Standards: Sections 229.35(a) and 229.38(d) and Appendix D

In the current processing environment, banks generally print or ''spray'' indorsements on original checks when the checks are processed through the banks' automated check sorters. A substitute check will contain previous indorsements physically applied to the original check by preserving the image of the back of the original check. In addition, the reconverting bank will print, or ''overlay,'' on the back of the substitute check any previous indorsements that were applied to the original check electronically and the reconverting bank's own indorsement. Banks handling checks downstream from reconverting banks generally will process a mix of original checks and substitute checks through their sorters and spray indorsements on both.

ANS X9.90 presumes that banks that receive paper checks, including substitute checks, will continue to spray indorsements on those checks in the same locations that they do today. ANS X9.90 also presumes that indorsements physically applied to a check before it is reconverted will be preserved through the accurate image of the back of the check that a substitute check must contain. However, the locations that ANS X9.90 specifies for previously applied electronic indorsements that a reconverting bank physically overlays on substitute checks and for the reconverting bank's own indorsement differ from the indorsement locations specified in current appendix D. In particular, the current appendix requires the depositary bank indorsement to be placed on the back of the check between 3 inches from the leading edge and 1.5 inches from the trailing edge, whereas ANS X9.90 requires a depositary bank's previously applied electronic indorsement to be overlaid by the reconverting bank on the back of a substitute check between 1.95 and 2.55 inches from the leading edge.[13] The current appendix requires a subsequent collecting bank indorsement to be placed on the back of the check between the leading edge and 3.0 inches from the leading edge, whereas ANS X9.90 requires a subsequent collecting bank's previously applied electronic indorsement to be overlaid by the reconverting bank on the back of a substitute check very close to the trailing edge.

The Board believes that, in light of technical constraints, existing check sorting equipment will not be able to modify in real time the location of the indorsements that the equipment sprays onto a check based on whether the check is an original check or a substitute check. The Board therefore proposes that the appendix's current location specifications would apply to indorsements printed on original checks and indorsements printed on existing substitute checks. Banks that do not create substitute checks generally would comply with the amended appendix D requirements by indorsing original checks and existing substitute checks exactly as they indorse original checks today. However, the Board proposes to amend appendix D to include new indorsement locations with which a reconverting bank must comply when it creates a substitute check. These locations would conform to ANS X9.90's location specifications for indorsements applied to a substitute check by a reconverting bank.

The Board also notes that ANS X9.90 provides that an image of an original check will be reduced in size when placed on a substitute check. Images of business-sized checks will be reduced to about 65 percent of their original size and images of personal-sized checks will be reduced to about 80 percent of their original size. Because of this size reduction, the location of an indorsement, particularly a depositary bank indorsement, sprayed on an original paper check likely will change when a reconverting bank creates a substitute check that contains that indorsement within the image of the original paper check. The Check 21 Act places ultimate liability on the reconverting bank for certain losses related to substitute checks. The Board believes that the reconverting bank also should bear the liability under § 229.38(d)(1) (which allocates liability for losses due to illegible indorsements) for any loss that results due to the shift in the placement of the indorsement. The Board proposes to amend that section and its commentary to explain this reconverting bank liability.

Appendix D currently requires depositary bank indorsements to be printed in dark purple or black ink and requires all other indorsements to be printed in an ink color other than purple. The Board does not believe that the use of differing ink colors significantly aids returning banks' ability to identify the depositary bank indorsement. However, the Board does believe that it is important for all indorsements to be printed in dark ink so that they can be easily read and imaged. The Board further believes that all indorsements that a reconverting bank prints onto a substitute check at the time that the substitute check is created will be printed in a single ink color, likely black. The Board therefore proposes to require all indorsements, including the depositary bank indorsement, to be printed in black ink.

Current appendix D requires a depositary bank to include its name and location in its indorsement. However, ANS X9.37 does not include this data in an electronic depositary bank indorsement record, and as a result this data will not be included when a reconverting bank overlays a depositary bank indorsement onto a substitute check. Nevertheless, a depositary bank that sprays its indorsement onto a check may wish to include this information in its indorsement to limit the number of locations at which it must accept returned checks. The Board therefore proposes to permit but not require the inclusion of the depositary bank's name and location in its indorsement.

Appendix D currently does not contain any content requirements for returning bank indorsements and implicitly permits the indorsements to be placed on the front of the check. Under ANS X9.90, however, a returning bank that also is a reconverting bank with respect to a substitute check must be identified as such on the back of the check. The Board therefore proposes to

[13] When looking at a check from the front, the leading edge is the right edge of the check and the trailing edge is the left edge of the check.

amend appendix D to require returning bank indorsers to comply with the same indorsement requirements as collecting banks. Specifically, the Board proposes to require that a subsequent collecting bank or returning bank indorsement be applied to the back of a check and include only (1) the bank's nine-digit routing number, and, if the 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. The Board requests comment on what benefits, if any, there would be in providing returning banks with the flexibility to indorse on the front of checks and to include additional information in their indorsements.

The Board notes that Regulation CC does not require paying banks to indorse checks. To facilitate compliance with section 4 of the Check 21 Act, however, a paying bank that also is a reconverting bank with respect to a substitute check should be identified as such on the check in a manner that a subsequent reconverting bank can preserve.[14] The Board therefore proposes to amend appendix D to require a paying bank that is also a reconverting bank with respect to a substitute check to identify itself as such by placing on the back of the check its nine-digit routing number (without arrows) and an asterisk at each end of the number. This identification would not constitute an indorsement.

Finally, for purposes of clarity, the Board proposes other technical amendments to appendix D.

The Board requests comment on all aspects of the proposed indorsement and identification standards discussed above.

E. Section 229.51 General Provisions Governing Substitute Checks

1. Legal Equivalence and Agreement

Section 4(b) of the Check 21 Act provides that a substitute check is the legal equivalent of the original check for all purposes and all persons if the check contains an accurate image of the front and back of the original check and bears a specified ''legal equivalence'' legend. Although section 4(b) does not mention warranties as a precondition of legal equivalence, section 4(a) provides that any person may deposit, present, collect, or return a substitute check without the agreement of the recipient so long as a bank has made the substitute check warranties with respect to that check. Section 4(a) clearly intends that persons are required to accept a substitute check without agreement only if a bank has provided the substitute check warranties. The Board therefore believes that section 4(a) in effect requires a bank warranty as another prerequisite of legal equivalence. Section 229.51(a) of the proposed rule would make this requirement explicit by providing 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.

The proposed commentary to § 229.51(a) reiterates that a substitute check created by a person other than a bank can be transferred only by agreement unless and until a bank makes the substitute check warranties with respect to that check. The proposed commentary clarifies that a substitute check created by a person who is not a bank therefore cannot be the legal equivalent of the original check absent a bank's agreement to make the substitute check warranties. The commentary also provides clarification about what information on the check must be accurately represented as a prerequisite for legal equivalence. Finally, the commentary to § 229.52(b)(2) states that the legal equivalence legend must use the language specified in that section.

2. Reconverting Bank Duties

Proposed § 229.51(b)(1)–(2) contains the reconverting bank duties described in sections 4(c) and 4(d) of the Check 21 Act regarding indorsements and identifications. In addition, § 229.51(b)(3) requires a reconverting bank to identify the bank that truncated the original check. The Board proposes to impose this requirement by regulation because ANS X9.90 requires identification of the truncating bank and because it is likely that banks in the collection and return chain would want to identify the truncating bank if there were a problem with a substitute check because the truncating bank would be in the best position to provide the original check or additional information about the original check. The proposed regulation requires the reconverting bank and truncating bank identifications to be applied in accordance with generally applicable industry standards and with appendix D of Regulation CC.

The proposed commentary to § 229.51 provides that, although a reconverting bank is responsible for preserving all previously-applied indorsements, it is not responsible for obtaining indorsements that should have been applied but were not. The proposed commentary also notes that some previously applied indorsements will be preserved because they will be shown on a substitute check's image of the back of the original check, whereas the reconverting bank must physically apply to the back of the substitute check any previous indorsements that were applied electronically. The proposed commentary also notes that, under appendix D, the reconverting bank indorsement and identification are set off with asterisks and the truncating bank identification is set off with brackets. The proposed commentary also makes clear that preservation of a previous reconverting bank's indorsement (or identification, if the reconverting is the paying bank) set off by asterisks on the back of the check also satisfies the requirement of preserving the previous reconverting bank's identification.

3. Legal Status of an Item That Purports To Be a Substitute Check But Is Not

As described in the discussion above concerning the definition of a substitute check, a reproduction of an original check that does not have the same MICR line as the original check would not be a substitute check. However, the Board believes that a bank that transfers such an item as if that item were a substitute check should not be allowed to evade the requirements of the Check 21 Act and subpart D simply because the item it created failed to meet the substitute check definition.[15] To protect recipients of such items and to provide incentives for reconverting banks to ensure that they only transfer items that comply with subpart D, the proposed rule provides that the recipient of an item that purports to be but is not a substitute check has warranty and indemnity rights, and, where applicable, recredit and consumer awareness disclosure rights under subpart D as though the item were a substitute check. The Board requests comment on whether an item

[14] If the paying bank were a reconverting bank and did not identify itself as such on the back of the check, then the only place the paying bank would be identified as a reconverting bank would be the routing number of the paying bank, surrounded by asterisks, on the front of the check (according to ANS X9.90). If the substitute check were subsequently converted to electronic form and reconverted to paper, the identification of the paying bank as a reconverting bank on the front of the check would be lost, because its routing number would be replaced with the identification of the subsequent reconverting bank. This would place the subsequent reconverting bank in violation of the Check 21 Act's requirement ''to preserve any previous reconverting bank identifications'' (*see* section 4(d) of the Check 21 Act).

[15] An item could purport to be a substitute check, for example, if it contained the legal equivalence legend or if a person provided the item when applicable law required production of the original check.

that fails to meet any of the other the substitute check requirements in § 229.2(zz) also should be treated as though it were a substitute check for those limited purposes.

4. Applicable Law

Proposed § 229.52(c) incorporates the Check 21 Act's provision stating that a substitute check that meets the legal equivalence requirements is subject to any existing federal or state law as though it were the original check, to the extent that such provision is not inconsistent with the Check 21 Act. The proposed commentary to this section clarifies that a law is not inconsistent with the Check 21 Act merely because it allows for the recovery of additional damages.

F. Section 229.52 Substitute Check Warranties

Proposed § 229.52 of the rule implements section 5 of the Check 21 Act, which contains new warranties relating to substitute checks. For purposes of clarity, the proposed rule is organized differently than the Check 21 Act.

1. Content and Provision of the Substitute Check Warranties

Proposed § 229.52(a) sets forth the content of the substitute check warranties and identifies the banks that provide, and the events that trigger provision of, those warranties. The warranties are (1) that the substitute check meets the requirements for legal equivalence (*i.e.,* that the substitute check accurately represents the information on the front and back of the original check and bears the legal equivalence legend) and (2) that no depositary bank, drawee, drawer, or indorser will be asked to make payment based on a check that it already has paid.

In describing the second warranty, the Check 21 Act provides that none of the named parties will receive ''presentment or return'' of an item such that it will be asked to make a duplicative payment. However, one such recipient, the drawer, typically would not receive presentment or return of a check but rather would have its account charged for the check. The proposed rule therefore states that the named parties will not receive presentment or return of, or otherwise be charged for, a duplicative item.

The Check 21 Act states that each of the two warranties is made when a bank transfers, presents, or returns a ''substitute check'' for consideration. However, the list of warranty recipients, which includes persons that received some other paper or electronic form of the substitute check, indicates that banks continue to provide the warranties even if they transfer and receive consideration for something that is not, but that was derived from, a substitute check. Section 229.52(a) of the proposed rule therefore provides specifically that a bank makes the warranties when it transfers, presents, or returns for consideration the substitute check or any paper or electronic representation of a substitute check.

The Board notes that the Check 21 Act and the proposed rule state that the warranty against duplicative presentment or return applies such that the depositary bank, drawee, drawer, or indorser will not receive presentment or return ''of the substitute check, the original check, or a copy or other paper or electronic version of the substitute check or original check'' such that that person ''will be asked to make a payment based on a check'' it already has paid. This language could be read to exclude a situation where a second charge results from an ACH debit that was created using information from an original check or substitute check.[16] However, such an ACH debit arguably could be considered ''an electronic version'' of a substitute check or original check to which the duplicative payment warranty would apply. The Board specifically requests comment on whether using information from a check to create an ACH debit entry should be a payment request covered by this warranty.

The proposed commentary to § 229.52(a) clarifies that the reconverting bank is the first bank to provide the substitute check warranties. That discussion also notes that, when a bank is a reconverting bank because it by agreement receives a substitute check that a nonbank created, the reconverting bank starts the warranty chain for that substitute check even if the reconverting bank transfers an electronic representation of that substitute check instead of the actual substitute check that it received. The proposed commentary also clarifies that a bank that by agreement transfers an electronic version of an original check prior to the creation of the first substitute check does not make the substitute check warranties, but that parties to the agreement can allocate amongst themselves liabilities associated with the substitute check warranties. Moreover, the proposed commentary discusses the mechanics of each of the two warranties, including how they apply when multiple substitute checks are created with respect to the same payment transaction.

2. Warranty Recipients

Section 5 of the Check 21 Act provides that warranties are provided to ''the transferee, any subsequent collecting or returning bank, the drawee, the drawer, the payee, the depositor, and any endorser (regardless of whether the warrantee receives the substitute check or another paper or electronic form of the substitute check or original check) * * *'' Although § 229.52(b) of the proposed rule lists all these persons as warrantees, it does so in a slightly different manner than the statute. The warranties are intended to flow forward to all persons, including the paying bank, that received a substitute check or any paper or electronic representation of a substitute check, but not backward to persons that handled only the original check or some representation of the original check that was not derived from a substitute check. The rule therefore states that the warranties are provided to the recipient and any subsequent recipient, including all of the parties specifically listed in the statute, regardless of whether the recipient received the substitute check or another paper or electronic representation of the substitute check. The proposed commentary to § 229.52(b) provides additional discussion about the flow of the warranties.

G. Section 229.53 Substitute Check Indemnity

1. Scope of Indemnity

Section 6 of the Check 21 Act specifies the scope and amount of the substitute check indemnity, and the proposed rule incorporates this section largely unchanged. The proposed rule states that 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 depositary 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. As with the proposed rule's language regarding the scope of the warranties, discussed in detail in the analysis of § 229.52, the proposed

[16] Such ''check conversions'' are covered under the Board's Regulation E and rules of the National ACH Association as electronic fund transfers rather than check transactions and are not, to the Board's knowledge, treated as check transactions for any other purpose.

language regarding the scope of the substitute check indemnity clarifies that the indemnity flows to subsequent, not prior, parties that receive a substitute check or a representation of a substitute check.

The proposed commentary regarding the scope of the indemnity highlights that the indemnity applies only if the first indemnified party incurred a loss due to receipt of the substitute check instead of the original check. However, a bank that paid an indemnity (other than the first reconverting bank) would in turn be eligible to make an indemnity claim even if that bank only received a representation of a substitute check. Thus, the indemnity covers losses suffered directly due to the receipt of a substitute check instead of the original check and losses incurred by providing an indemnity to another person. The proposed commentary provides several examples to illustrate the scope of the indemnity.

2. Indemnity Amount

The proposed rule incorporates the statutory language regarding the indemnity amount with minor clarifications. The rule provides that the amount of the indemnity is (1) the amount of any loss (including interest, costs, reasonable attorney's fees, and other expenses of representation) caused by the breach of a substitute check warranty, or (2) in the absence of a breach of a substitute check warranty, the amount of the loss, up to the amount of the substitute check, plus interest and expenses (including costs and reasonable attorney's fees and other expenses of representation). The proposed rule supplements the statutory language by specifically stating that interest would be included in the damages proximately caused by a breach of a substitute check warranty.

The proposed rule also incorporates statutory provisions regarding reduction of the indemnity amount. Section 229.53(b)(2) of the proposed rule states that the indemnity amount described in the preceding paragraph will be reduced in proportion to the amount of negligence or bad faith of the party making the indemnity claim, but that nothing in that comparative negligence section reduces any person's rights under the U.C.C. or other applicable law. Section 229.53(b)(3) of the proposed rule provides that an indemnifying bank will be liable only for losses incurred up to the time that it produces the original check or a sufficient copy of the original check, although production of that item does not absolve the indemnifying bank from liability for breaching a substitute check warranty or a warranty established under any other law.

The proposed commentary to § 229.53(b) provides examples that illustrate the amount of the indemnity under various sets of facts.

3. Subrogation of Rights

Section 229.53(c) of the proposed rule incorporates section 6(e) of the statute by providing that an indemnifying bank shall be subrogated to the rights of the party it indemnified to the extent of the indemnity provided and may attempt to recover from another party based on a warranty or other claim. This section also provides that the indemnified party has a duty to comply with reasonable requests for assistance made by the indemnifying bank with respect to such a claim. The proposed commentary provides an example of what would constitute a reasonable request for assistance.

H. Section 229.54 Expedited Recredit for Consumers

Section 7 of the statute sets forth the circumstances giving rise to a consumer expedited recredit claim, the time period and procedures for making such a claim, the conditions for a recredit, the timing and availability of a recredit, a bank's ability to reverse a recredit on a later determination that the consumer's claim was not valid, and the notices a bank must provide in connection with recredit claims. Section 229.54 of the proposed rule implements all of these provisions but reorganizes them for purposes of clarity. The Board also proposes to supplement the statutory text in certain respects in order to explicitly acknowledge certain actions that are implicit in the text of the statute.

1. Circumstances Giving Rise to a Claim

Section 229.54(a) of the proposed rule provides that a consumer may make an expedited recredit claim under that 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 the 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 of the original check is necessary to determine whether or not the substitute check in fact was improperly charged or whether the consumer's warranty claim is valid. This section implements sections 7(a)(1) and 7(h) of the Check 21 Act with some organizational changes.

The proposed commentary on the circumstances giving rise to a claim provides additional detail concerning when a consumer would and would not meet the criteria for bringing an expedited recredit claim under § 229.54. For example, the commentary clarifies that a consumer who receives only an image statement that contains an image of a substitute check cannot make a claim because he or she has not actually received a substitute check, although such a consumer would have redress for an improper charge associated with the substitute check under the U.C.C. and might have a claim for breach of a substitute check warranty. The commentary also notes that the warranty giving rise to a § 229.54 claim could be a substitute check warranty or any other warranty provided to the consumer in connection with the substitute check. The commentary further notes that recovery under § 229.54 is limited to the amount of the substitute check, plus interest if the consumer has an interest-bearing account, although a consumer may be able to recover additional amounts under other law, including §§ 229.52 and 229.53 of the proposed rule.

2. Procedures for Making Claims

a. *Timing of Claim.* The Check 21 Act states that a consumer's expedited recredit claim is due before the end of the 40-day period beginning on the later of the date that the bank mailed or delivered to the consumer the periodic account statement that contains information about the transaction giving rise to the claim or the date on which the bank made the substitute check available to the consumer. Section 229.54(b)(1)(i) of the proposed rule implements this provision. The proposed rule clarifies that the 40-day time period refers to calendar days and that a bank makes a substitute check ''available'' by mailing or delivering it to the consumer.

The statute provides that the bank must extend the consumer's time for making a claim by a reasonable period of time if the consumer cannot meet the 40-day deadline due to extenuating circumstances, such as his or her extended travel or illness. Section 229.54(b)(1)(ii) of the proposed rule includes the general provision regarding the time extension but moves to the commentary the specific examples of what constitutes an extenuating circumstance. This parallels the

approach the Board took when implementing the Electronic Fund Transfer Act (*see* 15 U.S.C. 1693(g) and 12 CFR 205.6(b)(4)).

b. *Content of Claim.* Section 229.54(b)(2) of the proposed rule states that the consumer's claim must include (1) 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; (2) a statement that the consumer suffered a loss and an estimate of the amount of that loss; (3) the reason why production of the original check or a sufficient copy of the original check 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 (4) sufficient information to allow the bank to identify the substitute check and investigate the claim. The proposed rule uses the defined term ''sufficient copy,'' as opposed to the Check 21 Act's ''better copy,'' of the original check. As defined, a sufficient copy by its nature would be a better copy.

The proposed commentary to § 229.54(b)(2) discusses in more detail the reasons why a charge to the consumer's account could be improper and why the original check or a sufficient copy would be necessary to determine the validity of the consumer's recredit claim. The proposed commentary also discusses what types of information a consumer should provide to facilitate the bank's investigation of a claim.

c. *Form and Submission of Claim.* Section 229.54(b)(3) of the proposed rule incorporates the statutory provisions regarding the bank's ability to require a consumer to submit an expedited recredit claim in writing and the bank's ability to accept a written submission electronically. The proposed commentary to § 229.54(b)(3) clarifies that a bank that requires a claim to be in writing must inform the claimant of that requirement and also indicates that a communication, whether oral or written, that does not contain all the required information does not constitute a ''claim'' under § 229.54.

Although the statute states that a bank may permit an electronic submission ''if the consumer has agreed to communicate with the bank in that manner,'' the proposed rule omits the quoted language. The Board believes that a consumer's act of submitting a claim electronically indicates the consumer's agreement to communicate electronically, such that the statute's agreement language is unnecessary. However, the proposed commentary notes that a bank cannot require a consumer to submit a written claim electronically.

The proposed rule also clarifies that a bank that requires the consumer's claim to be in writing must compute the time period for acting on the claim from the date that the consumer submitted the written claim, even if the consumer previously provided some information relating to the claim in another form.[17] In addition, the statute measures time from the ''business day'' (defined as any day, other than a Saturday, Sunday, or legal holiday) on which the bank received a claim. However, the Board proposes to incorporate the term ''banking day,'' as it has for other parts of Regulation CC. Banking day means ''that part of any business day on which an office of a bank is open to the public for carrying on substantially all of its banking functions.'' The Board believes that ''banking day'' is an appropriate term when referring to the time at which a bank must begin measuring the time period for action. The Board requests comment on both of these adjustments relating to time period calculations.

3. Action on Claims

Section 7(c)(1) of the Check 21 Act requires a bank that receives a complete and timely claim for which all the prerequisites are met to recredit the consumer's account for the amount of the substitute check, plus interest if the consumer's account is an interest bearing account, unless the bank has provided the original check or a sufficient copy to the consumer and demonstrated to the consumer that the substitute check was properly charged to his or her account. Section 7(c)(2) of the Check 21 Act requires the bank to provide the recredit no later than the end of the business day following the business day on which the bank determined that the consumer's claim was valid or, if the bank has not yet determined the validity of the claim, before the end of the 10th business day after the business day on which the consumer recredited the claim. Section 7(c)(2) limits the amount that the bank is required to provide on the 10th day to the amount of the loss, up to the lesser of the amount of the substitute check or $2,500, plus interest, and requires the bank to provide the additional amount of the substitute check, if any, on the 45th calendar day following the business day on which the consumer submitted the claim. Section 7(e) of the Check 21 Act provides that a bank may reverse a recredit if it determines that the substitute check in question was properly charged to the consumer account and if it notifies the consumer.

The proposed rule incorporates each of the Check 21 Act's substantive requirements regarding action on a consumer's expedited recredit claim but reorganizes those requirements in a way that the Board believes is more straightforward. The Board requests comment on whether or not its proposed reorganization of the statutory provisions regarding action on claims is an improvement over the statutory organization and encourages commenters to provide specific organizational suggestions.

Section 229.54(c)(1) of the proposed rule provides that one of the bank's options for responding to a recredit claim is affirmatively to determine a consumer's claim to be valid. Although the statute does not list this possible response explicitly, the bank's ability to respond to a claim by determining that the claim is valid is implicit in the ''timing of the recredit'' section of the statute (section 7(c)(2)(A)), which requires the bank to provide a recredit the day after it determines that the consumer's claim is valid.

The statute provides that if a bank determines that the consumer's claim is not valid, the bank must provide the consumer with the original check or a copy of the original check sufficient to determine the validity of the claim and must demonstrate why the substitute check was properly charged to the consumer account. Because the statute provides that a warranty claim may be the basis of a consumer's expedited recredit claim, § 229.54(c)(2), by reference to § 229.54(e)(2), of the proposed rule requires the bank either to demonstrate that a charge was proper or to explain why the warranty claim is not valid, as appropriate in light of the consumer's claim.

Section 7(c) of the statute states that a bank must recredit the amount of the substitute check, plus interest if the account is an interest-bearing account. However, recrediting the full amount of the check could create overcompensation in some cases, such as where the consumer's allegation is that the bank charged the substitute check for the wrong amount. Section 229.54(c) of the proposed rule therefore provides that a bank must recredit the amount of the loss, up to the amount of the substitute check plus interest.

If, after providing a recredit, a bank later determines that the consumer's claim is not valid, § 229.54(c)(4) of the

[17] The commentary to this provision clarifies that a bank that requires expedited recredit claims to be in writing must inform the consumer.

proposed rule would allow the bank to reverse both the amount it previously recredited plus any interest that it has paid on that amount. The statute does not explicitly address the reversal of interest when reversing a recredit, and the Board specifically requests comment on whether the proposed approach is appropriate.

The proposed commentary to § 229.54(c) clarifies that a bank that receives claims for multiple substitute checks in the same communication must provide the expedited recredit for each such check by the 10th day after submission, unless the bank by that date has determined whether or not the claims are valid. The commentary also clarifies that a bank may, when appropriate, reverse any amount that it previously recredited, regardless of whether such amount originally was provided after a determination that a claim was valid or pending the bank's investigation of the claim. The Board requests comment on whether additional commentary to § 229.54 would be useful and, if so, what specific points should be covered.

4. Availability of Recredit

Section 7(d) of the statute provides that a bank can delay the availability of a recredit if the account is a new account or has been repeatedly overdrawn in the last six months, or if the bank has reasonable cause to suspect fraud. The proposed rule incorporates the statutory language with minor clarifications. The statute states that the new account exception applies if ''the claim is made'' within 30 days of establishment of the account, whereas the proposed rule provides that the exception applies if ''the consumer submits the claim'' within 30 days. This change clarifies when a claim ''is made'' in a manner that is consistent with the other time period calculations in the statute and proposed rule. The rule also reorganizes the language in the exception for prevention of fraud losses to parallel the existing exception for reasonable cause to doubt collectibility in § 229.13.

The proposed commentary to § 229.54(d) clarifies that the availability of recredits provided under § 229.54(c) is governed solely by § 229.54(d) and thus is not subject to subpart B. The commentary also clarifies that the periods in § 229.54(d) are the maximum periods that the bank may delay availability. In addition, the commentary clarifies that the bank may delay availability of a recredit under § 229.54(d) only with respect to the amount of the substitute check that the bank recredits under § 229.54(c)(3)(i) pending investigation of the consumer's claim.

5. Notices Relating to Consumer Expedited Recredit Claims

Section 229.54(e) of the proposed rule describes the notices required by the statute when a bank provides or reverses a recredit or denies a consumer's recredit claim. The proposed rule provides that a bank that recredits a consumer account must, no later than the business day after the banking day on which the bank provides the recredit, notify the consumer of the amount of the recredit and the date on which the recredited funds will be available for withdrawal.

The proposed rule requires a bank that determines that a consumer's claim is not valid to notify the consumer no later than the business day after the banking day on which the bank makes its determination. The proposed rule provides that an invalid claim notice must include an explanation of the basis for the bank's determination that the substitute check was properly charged or the consumer's warranty claim is not valid, plus the original check or a sufficient copy of the original check. The statute requires a bank that denies a consumer's expedited recredit claim to notify the consumer that he or she may request the information or documents on which the bank relied in making its determination. However, the proposed rule allows a bank that relies on information or documents in addition to the original check or sufficient copy to provide such information or documents with the notice or to indicate that the consumer may obtain them on request.

The proposed rule provides that a bank that reverses an amount it previously credited to a consumer account must notify the consumer no later than the business day after the banking day on which the bank made the reversal. This notice must include the information required for an invalid claim notice, plus the amount of the reversal, including both the amount of the recredit and the amount of paid interest, if any, being reversed, and the date on which the bank made the reversal.

The proposed commentary to § 229.54(e) clarifies that a bank may provide a required notice by U.S. mail or by any other means through which the consumer has agreed to receive account information. The commentary highlights that, if a bank is required to provide an original check or sufficient copy as part of the notice, a bank that provides a notice electronically satisfies that requirement by providing an electronic image of the original check or sufficient copy, if the consumer has agreed to receive that information electronically.

As discussed in the analysis of appendix C, the Board proposes model language for each of the notices required by § 229.54(e).

I. Section 229.55 Expedited Recredit for Banks

Section 8 of the Check 21 Act provides that a bank may make a claim against an indemnifying bank if (1) the claimant bank or a bank that the claimant bank has indemnified has received a claim for expedited recredit from a consumer or 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 a consumer expedited recredit with respect to such substitute check or otherwise has suffered a resulting loss; and (3) the production of the original check or a sufficient copy of the original check 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. The content requirements for an interbank expedited recredit claim essentially parallel those for a consumer expedited recredit claim but also state that a bank that provides a copy of a substitute check with its claim must take steps to ensure that such copy is not mistaken for a legally equivalent substitute check or handled for forward collection or return. An indemnifying bank may require the claim to be in writing and may permit the claimant bank to submit it electronically.

A claimant bank must bring its claim under section 8 of the Check 21 Act within 120 days of the transaction that gave rise to the claim, and the indemnifying bank must respond within 10 business days of receiving the claim by providing (1) a recredit, (2) the original check or a sufficient copy, (3) or information to the claimant bank as to why the indemnifying bank is not obligated to do (1) or (2). If the claimant bank later receives or reverses a recredit or otherwise receives compensation for the substitute check for which the indemnifying bank previously provided a recredit, then the claimant bank must reimburse the indemnifying bank. An indemnifying bank that provides an original check or sufficient copy also may be entitled to a refund under § 229.53 if it has provided a recredit that exceeds the losses the claimant bank sustained up to the day that the indemnifying bank provided the original check or sufficient copy.

The proposed rule implements section 8 of the statute with some minor organizational and clarifying changes. The rule clarifies that bank action on a claim is required by ''the end of'' the 10th business day after the relevant banking day, consistent with the parallel consumer recredit provision. Moreover, the proposed rule clarifies that, when an indemnifying bank requires a claim to be in writing, the 10-day period commences with the receipt of the written claim.

The proposed rule also clarifies both paragraphs of the Check 21 Act regarding the indemnifying bank's right to a refund. Section 7(c)(3) of the statute states that the ''claimant bank must refund * * * any amount previously advanced by the indemnifying bank.'' Without further elaboration, this provision could be read to mean that a claimant bank must give to the indemnifying bank more than the claimant bank recovered.[18] The rule makes clear that a claimant bank that receives other compensation for the substitute check does not have to refund to the indemnifying bank more than the claimant bank previously recovered from the indemnifying bank. In addition, section 8(d) of the statute provides that an indemnifying bank that produces the original check or a sufficient copy has the right to a refund under the indemnity section. Section 229.55(e)(2) of the proposed rule clarifies the statutory language by describing the amount to be refunded under that provision.

The proposed commentary to § 229.55 elaborates on the rule text in several respects. The commentary highlights that a bank could have a recredit claim either because it is obligated to provide a recredit to a consumer or another bank or because it has suffered a loss as result of catching a substitute check problem that, if uncaught, could have given rise to a consumer expedited recredit claim. The commentary provides examples about the types of losses that could give rise to consumer claim and the circumstances under which a bank could bring a valid claim. The commentary also provides additional information relating to the procedures for making claims.

J. Section 229.56 Liability

The Check 21 Act provides for delays in an emergency in section 9, the measure of damages in section 10, and the statute of limitations and notice of claims in section 11. Section 229.56 of the proposed rule incorporates each of those sections with minor technical changes in a manner that parallels existing subpart C liability provisions in § 229.38.

Section 229.56 (a) of the proposed rule provides that the amount of damages recoverable for a breach of a substitute check warranty or failure to comply with any provision of subpart D generally is limited to the amount of the loss or the substitute check, whichever is less, plus interest and expenses relating to the substitute check. This section contains exceptions, however, noting that a person could recover more than the generally applicable amount by bringing an indemnity claim or could recover less than the generally applicable amount if the person's negligence or bad faith contributed to the loss or if the person obtained a recredit under § 229.54 or § 229.55.

Section 229.56(b) of the proposed rule states that delay by a bank beyond the time periods described in subpart D is excused if such delay is attributable to one of the causes specified in that paragraph.

Section 229.56(c) of the proposed rule specifies the courts in which a person may bring an action to enforce subpart D and provides that such an action must be brought within one year after the cause of action accrues. The statute provides that a cause of action accrues as of the date the injured party first learns or reasonably should have learned of the facts and circumstances giving rise to the cause of action. The proposed rule clarifies that one of the facts and circumstances included in the concept of accrual is the identity of the bank against which the action is to be brought. This clarification is intended to make the date from which the statute of limitations is measured correspond to the date from which timely notice of a claim is measured.

Section 229.56(d) generally provides that, unless a person gives notice of a § 229.56 claim 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 indemnifying or warranting bank, the warranting or indemnifying bank is discharged from liability in an action to enforce a claim under subpart D to the extent of any loss caused by the delay in giving notice of the claim. However, this paragraph also states that a timely recredit claim by a consumer under § 229.54 constitutes timely notice under this paragraph.

The proposed commentary to § 229.54 briefly elaborates on each of the four paragraphs of that section in a manner that corresponds to the commentary for § 229.38.

K. Section 229.57 Consumer Awareness

This section of the proposed rule implements section 12 of the Check 21 Act, which requires a bank to provide a consumer awareness disclosure regarding substitute checks and substitute check rights to each consumer ''who receives original checks or substitute checks.'' The Board believes that the quoted language, when read with the statutory provisions governing distribution of notices, indicates that section 12 disclosures are intended only for (1) consumers who routinely receive paid checks with their account statements and (2) other consumers who receive substitute checks only on a case-by-case basis. The proposed rule reflects this interpretation.

The proposed rule specifically notes that, unless the bank already has provided the disclosure, a case-by-case disclosure is required when (1) a consumer receives a substitute check in response to his or her specific request for an original check or a copy of a check or (2) a check deposited by a consumer is returned unpaid to the consumer's account in the form of a substitute check. The Check 21 Act requires that when a bank provides a substitute check to a consumer in response to the consumer's request for a check, the bank must provide the consumer disclosure at the time of the request. This requirement may be impractical, however, as the bank may not know at the time of the request whether it will provide the original check, a substitute check, or some other copy of the check. Requiring the bank to provide the disclosure at the time of the request could prove unnecessarily burdensome to the bank and confusing to the consumer, because the consumer would receive a disclosure describing rights that may not apply to the item the consumer ultimately receives. The Board therefore has proposed two alternative rule provisions regarding when a bank must provide the disclosure to a consumer who requests a copy of a check. One alternative tracks the statute and requires a bank to provide the disclosure at the time of the request, but the other alternative requires provision of the disclosure at the time the bank provides the substitute check to the consumer. The Board specifically requests comment on which of these alternatives is preferable.

The proposed commentary to § 229.57 indicates that a bank may use the model substitute check disclosure in appendix

[18] For example, if the claimant bank received a recredit for $150 and then received a subsequent recovery for $100, the refund to the indemnifying bank should be the amount of the recovery ($100) rather than the entire amount previously advanced ($150).

C and will be deemed to comply with the disclosure content requirement(s) for which it uses the model disclosure. The commentary also provides examples of when a bank must distribute the required disclosure.

L. Section 229.58 Mode of Delivery

The Check 21 Act discusses in several places the form in which a bank must provide required information. The proposed rule, by contrast, has a separate section regarding mode of delivery that applies to the entire subpart. Section 229.58 provides that a bank may provide any information required by subpart D by U.S. mail or by any other means through which the recipient has agreed to receive account information. This section also specifically allows a bank that is required to provide an original check or a sufficient copy to provide an electronic version of the relevant paper document if the recipient has agreed to receive that information electronically. This latter provision addresses the potential inconsistency between section 7(f)(2) as interpreted at § 229.54(e)(2), which requires a bank denying a consumer's recredit claim to provide the original check or a sufficient copy (each of which is by definition a piece of paper), with section 7(f)(4), which permits a bank to provide the notices (which presumably means all components of the notice) electronically.

M. Section 229.59 Relation to Other Law

This section of the proposed rule implements section 13 of the Check 21 Act by stating that the Check 21 Act and subpart D supersede any provision of federal or state law, including the U.C.C., that is inconsistent with the Check 21 Act or subpart D, but only to the extent of the inconsistency.

N. Section 229.60 Variation by Agreement

Section 229.60 of the proposed rule implements section 14 of the Check 21 Act by providing that any provision of § 229.55 (expedited recredit for banks) may be varied by agreement of the banks involved, but that no other provision of subpart D may be varied by agreement by any person or persons.

O. Appendix C—Model Forms

Section 12(c) of the Check 21 Act requires the Board to publish model forms that banks can use to satisfy the content requirements of the consumer awareness disclosure required by that section. Section 229.57 of the proposed rule lists those content requirements. The statute provides that a bank that uses the model form published by the Board to comply with § 229.57 shall be treated as complying with that section if the form accurately describes the bank's policies and practices.

The Board proposes to include the required model disclosure as model C–5A in appendix C. The proposed model disclosure explains in very simple terms what a substitute check is, when the consumer expedited recredit right applies, and what a consumer must do to exercise that right. The Board requests comment on whether the proposed model disclosure is clear, accurate, and concise.

Although not required by statute to do so, the Board also proposes to publish in appendix C models for the notices a bank must provide in response to a consumer's expedited recredit claim under section 7(f) of the Check 21 Act and § 229.54(e) of the proposed rule. Although there is no statutory safe harbor that applies to the proposed model notices under § 229.54(e), the Board nevertheless believes that these model notices may be helpful to banks in complying with the regulation. In light of the absence of a statutory safe harbor, the Board specifically requests comment on whether providing model language for the § 229.54(e) notices is useful.

The Board proposes technical amendments to the introductory paragraph and table of contents of appendix C to reflect the inclusion of the new disclosure and notices. The Board also proposes to amend the commentary to appendix C to clarify the appropriate use of the new models.

II. Other Amendments to Regulation CC

The Board also is proposing at this time several amendments to existing Regulation CC and its commentary that are unrelated to the Check 21 Act. The Board requests comment on each of these proposed revisions and also welcomes comments about any other areas of the existing rule and commentary that should be clarified.

A. Section 229.2 Definitions

The Board proposes to amend the commentary to the definition of local paying bank (§ 229.2(s)) to provide additional detail regarding how to determine whether deposits mailed to a central check processing facility are local or nonlocal.

B. Section 229.10 Next-Day Availability

The Board proposes adding a sentence to the commentary to § 229.10(c) to clarify that a special deposit slip notice need not be posted at each teller window, although it must be posted in a place where consumers are likely to see it before making a deposit.

C. Section 229.13 Exceptions

The Board proposes to amend the commentary to § 229.13(g) regarding notices of exception holds to clarify that a bank providing such a notice electronically to a consumer must comply with the requirements of the Electronic Signatures in Global and National Commerce Act (the E-Sign Act).

D. Section 229.15 General Disclosure Requirements

The Board proposes to amend the commentary to § 229.15(a) regarding the general form of notices required by subpart B to clarify that a bank providing a notice electronically to a consumer must comply with the requirements of the E-Sign Act. The Board also proposes to explain in more detail in the commentary how a notice can be ''clear and conspicuous,'' as required in existing § 229.15(a), and under what circumstances a bank may provide a required notice in a language other than English.

E. Section 229.30 Paying Bank's Responsibility for Return of Checks

The Board proposes amending § 229.30(c)(1) regarding the extension for the deadline of a return or notice of nonpayment under the U.C.C. or Regulation J. The current paragraph allows extensions when a paying bank uses a means of delivery that ordinarily would result in receipt by the receiving bank's next banking day. At least one court has interpreted the current provision to permit an extension of the midnight deadline even when the check was received by a returning bank at a time that was too late for the returning bank to process the check that day (*see Oak Brook Bank* v. *Northern Trust,* 2001 U.S. App. LEXIS 15065 (7th Cir., 2001)). The proposed rule therefore would more specifically describe the applicable time of receipt to be the bank's cutoff hour for the next processing cycle (if sent to a returning bank) or next banking day (if sent to a depositary bank). This parallels the existing language in § 229.30(c)(2). The Board proposes corresponding changes to the commentary to this section.

F. Section 229.33 Notice of Nonpayment

The Board proposes deleting the phrase ''with question marks'' at the end of § 229.33(b). Instead, the Board proposes to note in the commentary to

that section that a bank must identify an item of information if the bank is uncertain as to that item's accuracy by setting the item off with question marks, asterisks, or other symbols designated for this purpose by generally applicable industry standards. This change is meant to describe the actual industry practice more closely.

The Board also proposes amending the text of § 229.33(d) to state that a bank must ''send or give'' the consumer notice regarding receipt of a returned check or notice or nonpayment. This is meant to clarify that such a notice need not be in writing. The Board also proposes to add additional detail to the commentary to § 220.33(d) to describe the means by which a bank may provide the required notice.

The Board also requests comment on whether there are circumstances under which it would be appropriate to reduce the time frame for providing a notice of nonpayment.

G. Section 229.37 Variation by Agreement

The Board proposes to delete an obsolete reference from the last sentence of paragraph XXIII.A of the commentary to this section.

III. Specific Requests for Comment

In addition to the specific requests for comment discussed in the section-by-section analysis, the Board requests comment on the following issues.

A. Treatment of Generally Applicable Industry Standards

As discussed at various points in the section-by-section analysis, when the Check 21 Act or existing Regulation CC refers to generally applicable industry standards, the Board proposes including only a general reference to generally applicable industry standards in the rule text. However, if only one industry standard applies, the proposed commentary would identify that standard. If the Board determines to use this approach in the final rule, it could account for changes in industry standards simply by amending the commentary and would not need to change the underlying regulatory requirement that banks comply with industry standards. The Board requests comment generally on the desirability of this approach and specifically on whether commenters would prefer that the Board identify specific industry standards within the text of the rule.

B. Relation of the Check 21 Act to Other Law

The proposed commentary at various points attempts to clarify the interaction between the rights and remedies conferred by the Check 21 Act and those conferred by other law, particularly the U.C.C. The Board specifically requests comment on whether the proposed commentary is adequate with respect to the interaction between the Check 21 Act and existing law or whether commenters believe that additional discussion and examples are needed. If the latter, the Board requests that commenters be as specific as possible in describing which provisions of the Check 21 Act need clarification with respect to which provisions of existing law, and in identifying examples that should be added to the commentary.

C. Remotely-Created Demand Drafts

In 2002, the National Conference of Commissioners on Uniform State Laws and the American Law Institute approved revisions to Articles 3 and 4 of the U.C.C. regarding remotely-created consumer items. The U.C.C. revisions define a remotely-created consumer item to mean ''an item drawn on a consumer account, which is not created by the payor bank and does not bear a handwritten signature purporting to be the signature of the drawer.'' The U.C.C. revisions would require a person who 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.

The U.C.C. revisions are based on similar provisions enacted by certain individual states designed to address check fraud. (Some state laws and check clearinghouse rules refer to these items as ''demand drafts.'') As noted in the U.C.C. drafter's commentary, the revisions implement a limited rejection of *Price* v. *Neal,* 97 Eng. Rep. 871 (K.B. 1762), so that in certain circumstances (those involving remotely-created consumer checks) the paying bank can use a warranty claim to absolve itself of responsibility for honoring an unauthorized item. The revisions rest on the premise that monitoring by depositary banks can control this type of fraud more effectively than any practices readily available to paying banks.

The U.C.C. revisions have been adopted in at least one state and introduced in at least three others. The Board requests comment on whether it would be appropriate to incorporate the U.C.C. revisions into Regulation CC.

D. Use of Plain Language

Section 722 of the Gramm-Leach-Bliley Act requires the Board to use plain language in all its proposed and final rules. The Board requests comment on whether it could make the proposed regulatory language clearer and, if so, how.

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 proposed rule under the authority delegated to the Board by the Office of Management and Budget (OMB). The proposed rule contains requirements subject to the PRA.

The collection of information that is proposed by this rulemaking 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 financial institutions. The respondents that are regulated by the Board are state member banks and branches and agencies of foreign banks. Consumers who choose to make claims in accordance with § 229.54 of the proposed rule also would be respondents. The Board is estimating paperwork burden only for these three types of respondents; other federal banking agencies are required to estimate paperwork burden for the depository institutions for which they have administrative enforcement authority.

The proposed rulemaking contains several notice requirements and a disclosure requirement in relation to the Check 21 Act. The first notice, described in § 229.54(b)(2), is the information a consumer would provide when making an expedited recredit claim. The Federal Reserve estimates that each of the 949 state member banks and 295 branches and agencies will receive, on average, 25 of these claims per year. It is also estimated that it will take consumers, on average, 15 minutes to complete and send this claim. Thus, the Federal Reserve estimates that the combined annual burden for consumers submitting expedited recredit claims is 7,775 hours.

The second notice, described in § 229.54(e), is required when a bank validates the consumer's claim, denies a consumer's recredit claim, or reverses a consumer's recredit claim. The Federal Reserve estimates that each of the 949 state member banks and 295 branches and agencies will send, on average, 35 of these notices per year. It is also estimated that it will take the institutions, on average, 15 minutes to prepare and distribute each notice. Thus, the estimated total annual burden for these three bank notices is 10,885 hours.

The third notice, described in § 229.55(b)(2), is required for a bank making a claim against an indemnifying

bank for a substitute check. The Federal Reserve estimates that each of the 949 state member banks and 295 branches and agencies will submit, on average, 15 of these claims per year. It is also estimated that it will take institutions, on average, 15 minutes to complete and send each notice. Thus, the estimated total annual burden for this notice is 4,665 hours.

Finally, § 229.57 describes the disclosure requirement that state member banks or branches and agencies of foreign banks must provide to promote consumer awareness about substitute checks. Banks are required to provide a consumer awareness disclosure to consumers who receive paid checks with their periodic statements and consumers who request or otherwise receive paid checks on a case-by-case basis. A model disclosure is provided in appendix C–5A. The Federal Reserve estimates that each of the 949 state member banks and 295 branches and agencies will, on average, have 500 disclosures per year and that, on average, it will take 5 minutes to prepare and distribute the disclosure. Thus, the estimated total annual burden for this disclosure is 51,833 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. An OMB control number will be obtained. The Federal Reserve specifically requests comment on these burden estimates as described above.

Comments are also invited on: a. whether the proposed collection of information is necessary for the proper performance of the Federal Reserve's functions; including whether the information has practical utility; b. the accuracy of the Federal Reserve's estimate of the burden of the proposed information collection, including the cost of compliance; c. ways to enhance the quality, utility, and clarity of the information to be collected; and d. ways to minimize the burden of information collection on respondents, including through the use of automated collection techniques or other forms of information technology. Comments on the collections of information should be sent to Secretary, Board of Governors of the Federal Reserve System, Washington, DC 20551, with copies of such comments to be sent to the Office of Management and Budget, Paperwork Reduction Project (7100-to be obtained), Washington, DC 20503.

Regulatory Flexibility Act

The Board is proposing the foregoing amendments to implement the Check 21 Act and to provide clarification on existing regulatory provisions. The Check 21 Act requires the Board to publish model forms and clauses that banks may use to satisfy that statute's consumer awareness requirement. The Board also proposes to incorporate all provisions of the Check 21 Act that affect banks into existing Regulation CC, so that all federal provisions administered by the Board with respect to check collection will be described in one place.

The Check 21 Act and the proposed new subpart D that would implement it apply to all banks regardless of their size. The statute and proposed rule authorize, but do not require, banks to provide a new negotiable instrument called a substitute check when an original check is required. However, no bank is required to create substitute checks, and the impact on the check processing practices of banks that only receive and do not create substitute checks should be minimal. The proposed rule does, however, require all banks to provide a consumer awareness notice to consumers who receive substitute checks and to provide a notice to a consumer who, on a case-by-case basis, seeks a recredit for a substitute check that has caused the consumer to incur a loss. These disclosure and notice requirements are statutory.

The Board is not aware of any other federal rules that duplicate, overlap, or conflict with the proposed rule. The Board notes that the proposed rule is consistent with other parts of Regulation CC and the Board's Regulation J (12 CFR part 210) that apply to checks because those provisions would apply to properly-prepared substitute checks in the same manner that they apply to original checks.

The Board specifically requests comment on the impact of the proposed rule on small banks.

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 proposing to amend 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 *et seq.*, 12 U.S.C. 5001–5018.

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

§ 229.1 Authority and purpose; organization.

(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, as amended (12 U.S.C. 4001 *et seq.*) (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; and the disclosure and notices that banks must provide to consumers who receive substitute checks and who make expedited recredit claims.

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

§ 229.2 Definitions.

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 for purposes of subpart D of this part, *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. *Account* includes 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), remove the phrase ''subpart C'' from the last sentence of the undesignated paragraph and add the phrase ''subparts C and D'' in its place.

7. In § 229.2(q), insert 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 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:

(z) * * *

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 (ddd), 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 bank 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 generally applicable industry standards.

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

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

(yy) *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 receives the substitute check and transfers, presents, or returns that substitute check or, in lieu thereof, the first paper or electronic representation of that substitute check.

(zz) *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 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;

(3) Conforms in paper stock, dimension, and otherwise with generally applicable industry standards for substitute checks; and

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

(aaa) A *sufficient copy* of an original check is a copy of an original check that accurately represents all of the information on the front and back of that check as of the time it was truncated or that otherwise is sufficient to determine the validity of the relevant claim. 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.

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

(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)(i) Except as provided in paragraph (bbb)(2)(ii) of this section, 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 check.

(ii) A bank does not receive consideration when it transfers a substitute check or a paper or electronic representation of a substitute check solely in response to a person's warranty, indemnity, expedited recredit, or other claim with respect to the substitute check.

(ccc) *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.

(ddd) *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, 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.

§ 229.20 [Amended]

13. In § 229.20, remove the phrase ''the Act'' wherever it appears and add the phrase ''the EFA Act'' in its place.

§ 229.21 [Amended]

14. In § 229.21(g)(2), remove the phrase ''the Act'' and add the phrase ''the EFA Act'' in its place.

§ 229.30 [Amended]

15. In § 229.30(a)(2)(iii), remove the next-to-last sentence and add the following sentence in its place:

(a) * * *

(2) * * *

(iii) * * * A qualified returned check must be encoded in magnetic ink with the routing number of the depositary bank, the amount of the returned check, and a ''2'' or, in the case of a substitute check, a ''5'', in position 44 of the MICR line as a return identifier in accordance with generally applicable industry standards. * * *

* * * * *

16. In § 229.30, revise paragraph (c)(1), to read as follows:

(c)* * *

(1) On or before the receiving bank's cutoff hour for the next processing cycle (if sent to a returning bank) or on or before the receiving bank's next banking day (if sent to the depositary bank) following the otherwise applicable deadline, 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

* * * * *

§ 229.31 [Amended]

17. In § 229.31(a)(2)(iii), remove the second-to-last sentence and add the following sentence in its place:

(a) * * *

(2) * * *

(iii) * * * A qualified returned check must be encoded in magnetic ink with the routing number of the depositary bank, the amount of the returned check, and a ''2'' or, in the case of a substitute check, a ''5'', in position 44 of the MICR line as a return identifier in accordance with generally applicable industry standards. * * *

* * * * *

§ 229.33 [Amended]

18. In § 229.33(b), remove the phrase ''with question marks'' from the last sentence of the undesignated paragraph.

19. In § 229.33(d), add the phrase ''or give'' between the words ''send'' and ''notice.''

§ 229.35 [Amended]

20. 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 enables a subsequent collecting bank, paying bank, or returning bank to interpret the indorsement, in accordance with the indorsement standard set forth in appendix D of this part.

* * * * *

§ 229.38 [Amended]

21. In § 229.38(d)(1), add a new sentence between the next-to-last and last sentences and revise the last 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 by it adversely affects the ability of a bank to indorse the check legibly in accordance with § 229.35. Responsibility under this paragraph shall be treated as negligence of the paying bank, depositary bank, or reconverting bank for purposes of paragraph (c) of this section.

* * * * *

22. In § 229.38(f), remove the phrase ''the Act'' and add the phrase ''the EFA Act'' in its place.

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

23. Add a new subpart D to read as follows:

Subpart D—Substitute Checks

Sec.

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 generally applicable industry standards for substitute checks and appendix D of this part; and

(3) Identifies the bank that truncated the original check in accordance with generally applicable industry standards for substitute checks and appendix D of this part.

(c) *Purported substitute checks.* If a bank transfers, presents, or returns, and receives consideration for, an item that meets all the requirements of a substitute check except for the MICR line requirement in section 229.2(zz)(2), that item is a substitute check for purposes of §§ 229.52 through 229.57 of this subpart.

(d) *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 depositary 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) 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 depositary 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 the 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 depositary 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 any resulting 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 party'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 party.

(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 of the original check*—(i) If an indemnifying bank produces the original check or a sufficient copy of the original check, 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 party; 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 party that it indemnifies to the extent of the indemnity it has provided and may attempt to recover from another party based on a warranty or other claim.

(2) *Duty of indemnified party for subrogated claims.* Each indemnified party 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 party 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 the 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 of the original check 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 must 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 must submit his or her claim to the bank 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 must extend the 40-calendar-day period by an additional reasonable amount of time.

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

(i) 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;

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

(iii) The reason why production of the original check or a sufficient copy of the original check 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

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

(3) *Form and submission of claim; computation of time.* 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 may permit the consumer to submit the written claim electronically. A bank that requires the consumer to submit a written claim shall compute any time period in this subpart that begins with the submission of the claim from the date on which the consumer submitted the written claim.

(c) *Action on claims.* A bank that receives a claim that meets the requirements of paragraph (b) of this section must act as follows:

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

(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 must 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 consumer submitted the claim, the bank must—

(i) 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, by the end of that day and 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 consumer submitted 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 at any time may reverse a recredit that it has made to a consumer account under paragraph (c)(1) or (c)(3) of this section, plus interest the bank has paid, if any, on that amount, if the bank—

(i) Determines that a substitute check for which the bank recredited the consumer account in fact was properly charged to that account or that the consumer's warranty 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 consumer submitted the claim 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 must notify 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 must 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 notify the consumer no later than the business day after the banking day on which the bank makes that determination. This notice must include—

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

(ii) An explanation of the basis for the bank's determination that the substitute check was properly charged or the consumer's warranty claim is not valid; and

(iii) 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 credited to a consumer account must notify the consumer no later than the business day after the banking day on which the bank made the reversal. This notice must 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 and the amount of paid interest, 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 under § 229.53 or § 229.56.

§ 229.55 Expedited recredit procedures 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 of the original check 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 must 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 must submit its claim to the indemnifying bank 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 must 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 of the original check 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 must 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 may permit the claimant bank to submit the written claim electronically. A bank that requires the claimant bank to submit a written claim shall compute any time period in this subpart that begins with the submission of the claim 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 must—

(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 of the original check; or

(3) Provide information to the claimant bank regarding why the claimant 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 must 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 of the original check 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 lesser of the amount of the loss suffered by the person as a result of the breach or failure or 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 must 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 party 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 must provide, in accordance with paragraph (b) of this section, a disclosure to each of its consumer customers that describes—

(1) That a substitute check is the legal equivalent of an original check for all persons and for all purposes, including any provision of any federal or state law, if the substitute check meets the legal equivalence requirements described in § 229.51(a); 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 must provide the disclosure described in paragraph (a) of this section to a consumer who receives paid 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 consumer account opened after October 28, 2004.

(2) *Disclosure to consumers who receive substitute checks only an occasional basis.* Unless a bank already has provided the disclosure described in paragraph (a) of this section, the bank must provide such disclosure to a consumer customer of the bank who—

[Alternative 1: (i) Requests an original check or a copy of a check and receives a substitute check, at the time of such request;]

[Alternative 2: (i) Requests an original check or a copy of a check and receives a substitute check, at the time the bank provides such substitute check;] or

(ii) Receives a returned substitute check, at the time the bank provides such substitute check.

§ 229.58 Mode of delivery of information required by this subpart.

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 of an original check, 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.

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24. In appendix C, revise the title, 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 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 Availability Policy Disclosures

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C–5A Substitute Check Policy Disclosure

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Model Notices

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C–22 Expedited Recredit Claim, Full Refund

C–23 Expedited Recredit Claim, Partial Refund

C–24 Expedited Recredit Claim, Denial Notice

C–25 Expedited Recredit Claim, Reversal Notice

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25. In appendix C, after model C–5 add the following new model C–5A to read as follows:

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C–5A—Substitute Check Policy Disclosure

Substitute Checks and Your Rights

Some or all of the checks that you receive with your account statement or by request may look different than the check you wrote. To make check processing easier, a federal law permits banks to replace original checks with ''substitute checks.'' This notice describes substitute checks and the rights that you will have when you receive substitute checks.

What Is a Substitute Check?

A substitute check is a copy of an original check that is the same as the original check for all purposes, including proving that you made a payment, if it includes an accurate copy of the front and back of the original check and contains the words: ''This is a legal copy of your check. You can use it the same way you would use the original check.'' A substitute check that meets these requirements is generally subject to federal and state laws that apply to an original check. If you lose money because you received a substitute check, you have the right to file a claim for an expedited refund.

Your Right To File a Claim for an Expedited Refund

Federal law gives you the right to file a claim for an expedited refund if you receive a substitute check and believe that all of the statements below are true—

(1) The substitute check was incorrectly charged to your account (for example, this may be true if we charged your account for the wrong amount or if we charged your account more than once for the same check);

(2) You lost money as a result of the substitute check charge to your account; and

(3) You need the original check or a better copy of the original check to demonstrate that we incorrectly charged your account (for example, this may be true if you think that we charged your account for the wrong amount and the substitute check does not clearly show the amount).

Expedited Refunds

To obtain an expedited refund, you must send us a claim. Federal law limits an expedited refund to the amount of your loss, up to the amount of the substitute check, plus interest if your account earns interest. You should be aware that you could be entitled to additional amounts under other state or federal law.

How To Make a Claim for an Expedited Refund

Please make your claim [by calling (*phone number*), by writing to us at (*address*), or by e-mailing us at (*address*)]. You must make your claim within 40 calendar days of the later of these two dates:

(1) The date that we delivered the account statement showing the charge that you are disputing, or

(2) The date on which we made the substitute check available to you.

If there is a good reason (such as a long trip or a hospital stay) that you cannot make your claim by the required day, we will give you additional time.

Your expedited refund claim must—

(1) Describe why you think the charge to your account was incorrect;

(2) Estimate how much money you have lost because of the substitute check charge;

(3) Explain why the substitute check is not sufficient to show whether or not the charge to your account was correct; and

(4) Provide us with a copy of the substitute check or give us information that will help us to identify the substitute check and investigate your claim (for example, the check number, the name of the person to whom you wrote the check, and the amount of the check).

Our Responsibilities for Handling Your Claim

We will investigate your claim promptly. If we conclude that we incorrectly charged your account, we will refund to your account the amount of your claim (up to the amount of the substitute check, plus interest if your account earns interest) within one business day of making that decision. If we conclude that we correctly charged your account, we will send you a notice that explains the reason for our decision and includes either the original check or a better copy of the original check than the one you already received. If we have not made a decision on your claim within 10 business days after you submitted it, we will refund the amount that we owe to your account, up to $2,500, plus interest, by that date. We will refund the remaining amount, if any, plus interest, to your account by the 45th calendar day after you submitted your claim.

If we refund your account, on the next business day we will send you a notice that tells you the amount of your refund and the date on which you may withdraw that amount. Normally, you may withdraw your refund on the business day after we make it. In limited cases, we may delay your ability to withdraw up to the first $2,500 of the refund until the earlier of these two dates: (1) The day after we determine that your claim is valid; or (2) the 45th calendar day after the day that you submitted your claim.

Reversal of Refund

We may reverse any refund that we have given you if we later determine that the substitute check was correctly charged to your account. We also may reverse any interest we have paid you on that amount if your account earns interest. Within one business day after we reverse a refund, we will send you the original check or a better copy of the original check than the one you previously received, explain to you why the substitute check was correctly charged to your account, and tell you the amount and date of the reversal.

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

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C–22—Expedited Recredit Claim, Full Refund Notice

Notice of Refund

We have determined that your claim that a substitute check was incorrectly charged to your account is valid. We are refunding (*amount*) [of which (*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 that we credited to your account on (*date*).]

If we later determine that the substitute check was correctly charged to your account, we will reverse the refund by charging your account. We will notify you within one day of any such reversal.

C–23—Expedited Recredit Claim, Partial Refund Notice

Notice of Partial Refund

In response to your claim that a substitute check was incorrectly charged to your account, we are refunding (*amount*) [of which (*amount*) represents accrued interest] to your account, pending the completion of our investigation of your claim. You may withdraw these funds as of (*date*). [Unless we determine that your claim is not valid, the remaining amount of your refund will be credited to your account no later than the 45th calendar day after you submitted your claim.]

If we later determine that the substitute check was correctly charged to your account, we will reverse the refund by charging your account. We will notify you within one day of any such reversal.

C–24—Expedited Recredit Claim, Denial Notice

Denial of Claim

We reviewed your claim that a substitute check was incorrectly charged to your account. We are denying your claim. As the enclosed [(*original check*) or (*copy of the original check*)] shows, the charge to your account of (*amount*) was proper because (*reason, e.g. amount charged is the same or the signature is authentic*).

[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 claim that a substitute check was incorrectly charged to your account, we provided a refund of (*amount*) by crediting your account on (*date(s)*). We now have determined that the substitute check was correctly charged to your account. As the enclosed [(*original check*) or (*copy of the original check*)] shows, the charge to your account of (*amount*) was proper because (*reason, e.g. amount charged is the same or the signature is authentic*). As a result, we have reversed the refund to your account [plus interest we have paid you on that amount] by charging your account in the amount of (*amount*) 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.]

27. 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 depositary 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 depositary 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; and

(B) The indorsement date.

(ii) The indorsement also may contain—

(A) The bank's name or location;

(B) A branch identification;

(C) A trace or sequence number;

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

(E) 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.[1]

(iv) When printing its depositary bank indorsement or a previously applied electronic indorsement of the depositary bank 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 1.95 and 2.55 inches from the leading edge of the check.

(2) Each subsequent collecting bank or returning bank indorser shall protect the identifiability and legibility of the depositary 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 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 previously

[1] 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 Committee on Financial Services *Specification for the Placement and Location of MICR Printing, X9.13.*

applied electronic indorsement of a collecting bank or returning bank 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 depositary 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) If it is the paying bank with respect to the substitute check, then the reconverting bank 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, between 0.25 and 2.10 inches from the trailing edge of the check and within 0.575 inches from the top of the check, its nine-digit routing number (without arrows) and an asterisk at each end of the number.

(iv) The reconverting bank shall place on the front of the check, between 2.10 and 2.50 inches from the trailing edge of the check and within 2.6 inches from the top of the check, the truncating bank's nine-digit routing number (without arrows) and a bracket at each end of the number.

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

Appendix E—[Amended]

28. 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.

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 and interbank deposits, are included in the account definition for purposes of subpart D.

* * * * *

29. 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.

* * * * *

30. 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(zz) is a check for purposes of Regulation CC, even if that substitute check does not meet the requirements for legal equivalence set forth in § 229.51(a).

* * * * *

31. 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. * * *

* * * * *

32. 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 depositary 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 depositary bank located in one check-processing region sends a check that was deposited at that branch to the depositary 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 on 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 depositary bank.

* * * * *

33. 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.

* * * * *

34. 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. * * * Returned checks are identified by placing a ''2'' or, in the case of a substitute check, a ''5,'' in position 44 of the MICR line as a return identifier in accordance with American National Standard Specifications for Placement and Location of MICR Printing, X9.13 (hereinafter referred to as ''ANS X9.13'') for original checks or American National Standard Specifications for Image Replacement Documents, X9.90 (hereinafter referred to as ''ANS X9.90'') for substitute checks.

* * * * *

35. In appendix E to part 229, add new paragraphs II.QQ through II.DDD, 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 the generally applicable industry standards contained in ANS X9.13. As discussed in the commentary to the definition of substitute check, ANS X9.90 also applies to the content of the MICR line of a substitute check.

WW. 229.2(ww) Original Check

1. The definition of the term 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 or substitute check.

XX. 229.2(xx) [Reserved]

YY. 229.2(yy) 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(zz) is physically printed.

2. 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.

Examples. a. Bank A, by agreement, sends an electronic check file for collection to Bank B. If Bank B chooses to use that file to print a substitute check that meets the requirements of § 229.2(zz), Bank B is the reconverting bank as of the time it prints the substitute check. Bank A is not a reconverting bank because it handled the original check and electronic information about that original check but never created a substitute check.

b. Company A, which is not a bank, agrees to receive check information electronically from Bank A in order to create substitute checks on behalf of Bank A. Bank A creates a substitute check and becomes the reconverting bank when Company A prints a substitute check in accordance with that agreement.

3. 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. Under § 229.51, a substitute check is the legal equivalent of the original check only if a bank has made the substitute check warranties listed in § 229.52. A bank therefore is not required to accept a substitute check that was created by a person other than a bank and has not yet been transferred by a bank, although a bank may agree to do so.

Example. A bank's customer, which is a nonbank business, receives a check for payment and wants to deposit a substitute check instead of the original checks with the bank. If no other bank had yet handled the substitute check, the depositary bank that agreed to accept the substitute checks would be the reconverting bank as of the time the depositary bank transferred the substitute check (or other paper or electronic representation of that check) for collection or otherwise, presented the substitute check (or representation) to the paying bank, or returned the substitute check (or representation).

4. 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 payment transaction.

ZZ. 229.2(zz) Substitute Check

1. For purposes of this definition, a paper reproduction of an original check could include a reproduction created directly from an original check or a reproduction of the original check created from some other source, such as an electronic file or previous substitute check that contains an image of the original 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 and generally applicable industry standards is not a substitute check. Because a substitute check must be a representation of an item that is defined as a check under § 229.2(k), a paper reproduction of an image of something that is not a check cannot be a substitute check.

3. 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 on the back of a substitute check would include indorsements that were applied to the original check prior to truncation plus a physical representation of any indorsements that were applied electronically to the check after truncation but before creation of the substitute check.

Example. Bank A truncates an original check and, by agreement, transmits to Bank B an electronic image of the check accompanied by an 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 appendix D).

4. Some substitute checks will not be created directly from the original check, but rather will be created from a previous substitute check. In that case, the back of the subsequent substitute check would contain (1) the indorsements that were applied physically to the original check, (2) a physical representation of indorsements that were applied electronically to the original check after truncation but before creation of the first substitute check; (3) indorsements that were applied physically to the previous substitute check; and (4) 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. The front of a subsequent substitute check should contain an image of the front of the original check as that image appeared on the previous substitute check at the time the previous substitute check was converted to electronic form. Because information could have been physically added to the original check image contained 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.

5. The MICR line of a substitute check must contain the same information as the MICR line of the original check, except as provided by generally applicable industry standards for substitute checks to facilitate the processing of substitute checks.

Examples. a. The generally applicable industry standards contained in ANS X9.90 require the number appearing in position 44 of the MICR line of a substitute check to differ from the number that appeared in position 44 of an original check. On an original check, position 44 generally is left blank for forward collection and contains a ''2'' for a qualified returned check. ANS X9.90 provides that a substitute check used for forward collection should have a ''4'' and a qualified returned substitute check should have a ''5'' in position 44. The ''4'' and ''5'' indicate that the check image must be clipped at an appropriate size 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).

b. It is a generally applicable industry practice for a bank that detects an encoding error in the amount field of the original check (including omission of the amount) to correct that error by repairing the MICR line, such as by placing an additional MICR strip containing the paying bank's routing number and the correct amount of the check beneath the original MICR line. In accordance with the generally applicable MICR-line repair practice for original checks and to facilitate processing of substitute checks in the same manner as original checks, a bank that creates a substitute check from an original check with a misencoded or unencoded amount or a bank that handles a substitute check that reproduces an amount encoding error that appeared on the original check may correct the amount encoding error that the bank detects. Such a repair will not change the item's status as a substitute check under subpart D. A paper reproduction of an original check that reproduced an uncorrected amount encoding error that

appeared on the original check would, assuming all other requirements of the substitute check definition were met, be a valid substitute check that could be transferred, collected, or returned. However, subsequent banks that handled that substitute check and the drawer might have a claim for breach of an encoding warranty (see U.C.C. § 4–209 and § 229.34(c) of Regulation CC).

c. A MICR-line error could occur if the automated check sorter of the bank that truncated the original check electronically misinterpreted the MICR line data, such that the MICR line information actually used to process the check electronically was incorrect or incomplete. For example, if the check sorter detected but could not fully interpret the MICR line, the electronic MICR-line information would contain asterisks where the uninterpreted MICR data should appear. Similarly, the check sorter could have read a number in the MICR line incorrectly (such as reading a ''3'' instead of an ''8'') or intentionally substituted one character for another (such as replacing a space or a hyphen with a ''0'') when converting the MICR-line information to electronic form. Each of these differences from the MICR line of the original check constitutes a MICR-read error, and a paper reproduction of an original check that contained such a MICR-read error would not satisfy the substitute check definition. To ensure that the item transferred by the reconverting bank meets the substitute check definition, the reconverting bank should repair all MICR-read errors (see, for example, American National Standards Specifications for Electronic Exchange of Check and Image Data, X9.37, which contains provisions that facilitate the repair of the MICR line). As discussed in more detail in § 229.51(c) and the commentary thereto, a paper reproduction of an original check that contains a MICR-read error but that purports to be a substitute check, such as by containing the legal equivalence legend or by being delivered when an original check is required, would be a substitute check for purposes of §§ 229.52 through 229.57 of Regulation CC but would not be the legal equivalent of the original check.

6. A substitute check must conform to the generally applicable industry standards for substitute checks set forth in ANS X9.90 and must be suitable for automated processing in the same manner as the original check. Thus, an item that meets all other substitute check requirements but that contains a MICR line that is not printed in magnetic ink is not a substitute check. Similarly, a substitute check image that appears within an image statement containing multiple check images is not a substitute check because it does not contain a MICR line printed in magnetic ink and also is not the same size or suitable for automated processing in the same manner as an original check.

AAA. 229.2(aaa) Sufficient Copy and Copy

1. A bank may limit its liability for an indemnity claim and 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 relevant claim. A sufficient copy that contains an image of the back of the original check as of the time it was truncated also could contain additional information, such as subsequently applied indorsements.

2. A copy must be a paper reproduction of a check. An electronic image that appears on a computer screen but has not yet been printed therefore is not a copy or a sufficient copy. However, if an account holder 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.

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 always would constitute a sufficient copy. Thus, a substitute check that met the legal equivalence requirements would be a sufficient copy. In addition, a substitute check that accurately represented all the information on the front and back of the original check also would be a sufficient copy even if such substitute check did not bear the legal equivalence legend or if a bank had not made the substitute check warranties.

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. A clear copy of only the front of the original check that showed the amount of the check likely would be sufficient to determine whether the consumer had a valid claim.

BBB. 229.2(bbb) Transfer and Consideration

1. Under §§ 229.52 and 229.53, a bank makes the warranties and is responsible for the indemnity when it transfers a substitute check (or a representation thereof) for consideration. The Check 21 Act contemplates that drawers and other 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, although such parties normally are not transferees that receive consideration for purposes of the U.C.C. To ensure that these parties are covered by the substitute check warranties and indemnity, § 229.2(bbb) 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 non-bank 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 account 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 as a result of the substitute check (or representation thereof) thus would have rights under the Check 21 Act and subpart D against the paying bank, which is the bank with which it has a relationship, as well as against all previous warranting banks in the collection chain.

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 account statement transfers the substitute check for consideration and thereby provides the warranties.

c. Moreover, 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 to the depositor.

CCC. 229.2(ccc) 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.

DDD. 229.2(ddd) 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 a check that was truncated by a person that is not a bank.

Example. A bank's customer that is a nonbank business receives a check for payment and wants to deposit either a substitute check or an electronic representation of the original check with its depositary bank instead of the original. The depositary bank that agrees to accept a check in a form other than the original check would be the truncating bank. That bank also would be the reconverting bank if it were the first bank to transfer, present, or return a substitute check that it created or that it accepted from its nonbank customer (see § 229.2(yy) and the commentary thereto).

* * * * *

36. 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. * * *

* * * * *

37. 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 depositary 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 depositary 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.

* * * * *

38. 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 clear and conspicuous if it is reasonably understandable and designed to call attention to the nature and significance of the information in the disclosure (see the examples listed in § 216.3(b)(2) of this chapter). 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 depositary 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 depositary 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.

* * * * *

39. 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.

40. 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 X9.90 for substitute checks.

* * * * *

41. In appendix E, revise paragraph XVI.C.1.a. 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 either reaches the returning bank to which it is sent by that bank's cut-off hour for the next processing cycle after the applicable deadline or reaches the depositary bank to which it is sent by that bank's next banking day following the expiration of the applicable deadline. The extension also applies if the check reaches the bank to which it is sent later than the close of that bank's cut-off hour for the next processing cycle or its next banking day, as applicable, 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 cut-off hour for the next processing cycle. This paragraph applies to the extension of all midnight deadlines except Saturday midnight deadlines (see paragraph C.1.b. of this appendix).

* * * * *

42. 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 X9.90 for substitute checks.

* * * * *

43. 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, such as ANS X9.37.

* * * * *

44. In appendix E, paragraph XIX.D.1., insert 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 depositary 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).

* * * * *

45. In appendix E, paragraph XXI.A.1., remove the phrase ''are legible'' from the fourth sentence and add the phrase ''can be interpreted by a subsequent collecting bank, paying bank, or returning bank'' in its place.

46. In appendix E, paragraph XXI.A., remove existing paragraphs 2. through 6., remove paragraph 8., redesignate existing paragraph 7. as paragraph 8., and add the following paragraphs 2. through 7. to read as follows:

XXI. * * *

A.

* * * * *

2. Banks generally apply indorsements to paper checks in one of two ways: (1) Banks print or ''spray'' indorsements onto checks when the checks are processed through the banks' automated check sorters (regardless of whether the checks are original checks or substitute checks), and (2) reconverting banks print or ''overlay'' previously applied electronic indorsements and their own indorsements and identifications onto substitute checks at the time that the substitute checks are created. A substitute check will contain, in its image of the original check or previous substitute check, reproductions of indorsements that were sprayed 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 a ''previously applied electronic indorsement.'' 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 reconverting banks overlaying previously applied electronic indorsements and their own indorsements onto substitute checks at the time the substitute checks are created.

3. The location of an indorsement applied to an existing paper check in accordance with appendix D may shift if that check is truncated and later reconverted to a substitute check. If the indorsement is overwritten by a subsequent indorsement that also is applied in accordance with appendix D, then the indorsement could be

rendered illegible. See § 229.38(d) and the commentary thereto for information regarding liability for a loss that results from an illegible indorsement.

4. To ensure that indorsements can be easily read and imaged, the standard requires all indorsements applied to original checks and substitute checks to be printed in black ink.

5. The standard requires the depositary 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 depositary 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, and (2) the indorsement date. 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.

6. Depositary 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.

7. A depositary bank may want to include an address in its indorsement in order to limit the number of locations at which it must accept returned checks. In instances where this address is not consistent with the routing number in the indorsement, the depositary bank is required to accept returned checks at a branch or head office consistent with the routing number. Banks should note, however, that § 229.32 requires a depositary bank to accept returned checks at the location(s) at which it accepts forward-collection checks.

* * * * *

47. In appendix E, paragraph XXI.A.13, in the first sentence add the phrase ''collecting banks and'' between the phrases ''standard for'' and ''returning banks'' and add a new sentence to the end of the paragraph to read as follows:

XXI. * * *

A. * * *

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

* * * * *

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

49. 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 a 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, depositary bank, or reconverting bank, as appropriate, for keeping the back of the check clear for bank indorsements during forward collection and return. * * *

2. ANS X9.90 provides that an image of an original check should be reduced in size when placed on a substitute check: images of business-sized checks will be reduced to about 65 percent of their original size and images of personal-sized checks will be reduced to about 80 percent of their original size. Because of this size reduction, the location of an indorsement, particularly a depositary bank indorsement, applied to an original paper check will likely change when a 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.

Example. In accordance with appendix D's specifications, a depositary bank sprays its indorsement onto a business-sized original check between 3.0 inches from the leading 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 depositary 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 depositary bank indorsement. If the check is returned unpaid and the return is not expeditious because of the illegibility of the depositary bank indorsement, and the depositary bank incurs a loss that it would not have incurred had the return been expeditious, the reconverting bank bears the liability for that loss.

* * * * *

50. In appendix E, redesignate commentary XXX as commentary XXXVII and add new commentaries XXX through XXXVI 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. Any person therefore may transfer or otherwise provide such a check to any other person for any purpose without obtaining the recipient's agreement. Although a person still would be entitled to receive a paper check absent agreement to the contrary, that person would be required to accept a legally equivalent substitute check in lieu of the original check. A person that receives a substitute check cannot be assessed costs associated with the creation of the substitute check, absent agreement to the contrary.

2. A person other than a bank that creates a substitute check could transfer that check only by agreement unless and until a bank provided the substitute check warranties. For example, a nonbank that wanted to create substitute checks for the purpose of depositing such checks for collection could not deposit those substitute checks without the agreement of a depositary bank.

Example. A depositary bank could agree to allow a person that is not a bank to deposit substitute checks that person created. The depositary bank then would provide the substitute check warranties and become the reconverting bank when the bank transferred the check to another bank for collection, presented the check to the paying bank, or otherwise transferred the check. If the substitute check also met the accuracy and legend requirements for legal equivalence, as warranted, the transferee would be required to accept it just as it would the original check.

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. The 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; (2) 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; and (3) other information placed on the check prior to truncation, such as any required identification information 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).

4. To be the legal equivalent of the original check, a substitute check also 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 X9.90.

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 should be preserved through the image of the back of the original check. If indorsements were applied electronically after the original check was truncated 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.

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.

Example. A bank's customer, which is a nonbank business, receives checks for payment and wants to deposit substitute checks instead of the original checks with its depositary bank. A bank that agrees to accept these substitute checks for deposit would be the depositary bank and 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 X9.90, 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 depositary bank and a reconverting bank.

C. 229.51(c) Purported Substitute Checks

1. A reconverting bank must ensure that a substitute check 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. As discussed in the commentary to the substitute check definition, the MICR line of the substitute check could vary from the MICR line of the original check in two ways and still qualify as a substitute check: (1) The substitute check indicator in position 44 would be different on the substitute check and (2) the reconverting bank or a subsequent bank could correct an amount encoding error (including a failure to encode) that is traceable to the original check. If the MICR line differs in other ways from the MICR line of the original check, the item would not meet the definition of substitute check. If the item is handled as if it were a substitute check, however, this section provides that the warranties, indemnity, expedited recredit, liability, and consumer awareness provisions would apply to that item as if it were a substitute check. The item would not, however, be the legal equivalent of the original check.

D. 229.51(d) 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 substitute check warranties are first given by the reconverting bank. In the case of a substitute check created by a bank, the reconverting bank gives the 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 makes the warranties when it transfers for consideration either the substitute check it received or an electronic or paper representation of that substitute check. The warranties also are given by any subsequent bank that transfers for consideration either the substitute check or a paper or electronic representation of the substitute check. A paper representation of a substitute check could include an image of the substitute check contained within an image statement or information about the check (such as the check number and amount) that is included on a periodic account statement.

2. A bank that truncates the original check and by agreement transfers the check electronically to a subsequent bank for consideration does not make the substitute check warranties to the recipient of the electronic form of the original check, because the sending bank has not transferred for consideration a substitute check or paper or electronic representation of a substitute check. 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 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 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 that reproduced the same original check. When a check changes form multiple times in the collection or return process, the first reconverting bank and subsequent banks that transfer 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 reconverting banks, transferring banks, and returning banks

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. 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. Bank A uses check information that it received electronically to create a substitute check, which it presents to Bank B for payment. Bank A is a reconverting bank that made the substitute check warranties when it presented the check and received payment. An employee of Bank A later uses the electronic check information to create a second, identical substitute check, which he then deposits at Bank C. Bank C presents the second substitute check to Bank B for payment. Bank C also is a reconverting bank that has made the warranties as of the time it presented the second substitute check to Bank B. The drawer of the original check and Bank B could pursue a warranty claim against either Bank A or Bank C.

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 depositary 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. A person does not receive the warranties if it previously handled only the original check or a representation of an original check that was not derived from a substitute check. In other words, the warranties flow only forward to persons that receive a substitute check or something derived from a substitute check; they do not flow backward to persons that handled only an original check or an image of an original check that predated the first substitute check. However, a person that initially handled only the original check could become a warranty recipient if that person later received 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. As with the warranties, responsibility for providing the indemnity begins with the reconverting bank and is made by each bank that subsequently receives consideration for a substitute check (or a paper or electronic representation of the substitute check) that it transfers, presents, or returns. The indemnity covers losses by any subsequent recipient (including the subsequent collecting or returning bank, the depositary bank, the drawer, the drawee, the payee, the depositor, and any indorser) that are due to the fact that any recipient of a substitute check received a substitute check instead of the original check. As with the warranties, the indemnity is not provided to or by 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.

2. The indemnity would cover losses that a recipient suffered directly because it received a substitute check instead of the original check. The indemnity also would cover losses incurred because a person provided an indemnity, either to the person that suffered a loss due to the receipt of a substitute check or to another bank that provided an indemnity in connection with that loss. A bank that has provided an indemnity could, in turn, bring an indemnity claim regardless of whether that bank received the actual substitute check or a paper or electronic representation of the substitute check. The indemnity would not, however, cover a loss that was not ultimately traceable to the receipt of a substitute check instead of the original 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 and likely would have detected the fraud and returned the original check before its midnight deadline. 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 example, 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 the bank has established for examining security features, the bank likely would not have caught the error and accordingly would have suffered a loss even if it had received the original check.

c. A paying bank that made payment based on an electronic representation of the check and subsequently suffered a loss would not have an indemnity claim associated with that payment because its loss did not result from receipt of an actual substitute 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 check law.

d. A drawer has agreed with its bank that the drawer will not receive paid checks with periodic account statements. The drawer requests a copy of paid check in order to prove payment and received a photocopy of the front 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 depositor 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.

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 discovered that its account had been charged mistakenly for a purported substitute check because the substitute check contained an ''8'' in the account-number field of the MICR line where the original check contained a ''3.'' As a result of this erroneous 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)(1). The drawer also could assert an indemnity claim, because if the original check had been presented instead of the purported substitute check, the bank likely would not have charged the drawer's account. It is likely that the drawer would assert its warranty and indemnity claims against the paying bank, because that is the bank with which the drawer has an account relationship. 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 purported substitute check also would have a warranty claim against the previous transferor of the purported substitute check and could seek an indemnity from that bank. 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.

c. A person received a purported substitute check that did not contain the legal equivalence legend, could not use that item to prove payment, and suffered a resulting loss. The item did not contain the legend and thus did not meet one of the requirements for legal equivalence, as warranted, and the person suffered a loss that would not have been suffered had the original check been received instead. The person therefore could recover all damages proximately caused by the warranty breach.

2. If the recipient of the substitute check does not have a substitute check warranty claim with respect to the substitute check, its recovery under § 229.53 is limited to the amount of the substitute check, plus interest and expenses. However, the indemnified party 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 that was only charged once to the drawer's account, 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 and no person was asked to pay the substitute check more than once. In that case, the amount of the drawer's indemnity would be limited to the amount of the substitute check, plus interest and expenses, although 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 likely would have returned by its midnight deadline had it received the original check. However, if the legally equivalent substitute check was only presented once, 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 party'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).

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 party based on an indemnity, warranty, or other claim. The party 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 a U.C.C. warranty claim against a bank that previously handled the check. 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. Thus, a consumer that received only an image statement containing an image of a substitute check 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. section 4–401. However, a consumer who originally received only an image statement 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 § 229.34, the U.C.C., or other law.

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. A consumer who suffers a 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.

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 is 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. section 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 mailing, in-person, or electronic delivery of an account statement or by the mailing or in-person delivery of a substitute check. In the case of a mailed statement or substitute check, the 40-day period should be calculated using the postmark on the envelope.

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. 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.

5. 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.

6. 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.

7. 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 should inform the consumer of that requirement and provide a location to which such a written claim should be sent. For example, a bank could inform a consumer of the written notice requirement in the consumer awareness notice required by § 229.57 or, if the consumer attempts to make a claim orally, by informing the consumer at that time of the written notice requirement.

8. A bank may permit a consumer to submit a claim electronically. However, a bank cannot require that a written claim be submitted electronically.

9. If a bank requires a consumer to submit a claim in writing, the bank must compute time periods that begin with submission of a 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 placed the call.

10. 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.

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. For example, if a consumer sends claims with respect to two different substitute checks in the same envelope or e-mail, the bank must make the required provisional credit for each of the two claims by the 10th business day thereafter (unless the bank already determined whether or not those claims are valid in accordance with § 229.54(c)(1) or (c)(2)).

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 at any time 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.

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 withdrawn 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 (see § 229.13(a) and (d)).

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) 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 explain the reason that it is denying the claim, such as the reason the bank believes the substitute check 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 of the original check, 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. If a consumer receives an electronic image of the original check or an electronic image of a sufficient copy, the consumer could obtain a sufficient copy simply by printing that image.

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. Therefore, use of these models may, but will not necessarily, be deemed to be compliance with the requirements of § 229.54(e).

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 compensation to a consumer or to a bank in connection with a consumer expedited recredit claim under § 229.54.

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 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. The length of the time period for bringing an interbank recredit claim allows multiple banks that might have suffered a loss as a result of a particular transaction sufficient time to bring a claim. The time period also allows for the delay between the transaction date and the due date for the consumer's claim under § 229.54.

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 explain 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, reasonable attorney's fees, and other expenses of representation. As a practical matter, a person likely would seek to recover under § 229.53 if it received the problematic substitute check and under § 229.56 if it did not.

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.

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. Each bank must provide the disclosure required by this section to each of its consumer customers who receives paid checks with his or her account statement or who otherwise receives substitute checks.

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 bank must provide the disclosure described in § 229.57(a) to each consumer who routinely receives paid checks with his or her periodic account statement. A bank also must provide the disclosure to a consumer who does not routinely receive his or her checks but rather receives a substitute check on an occasional basis, unless the bank previously provided the disclosure to that consumer.

Examples. a. A consumer who does not receive paid checks with each periodic account statement may request a copy of a check on a case-by-case basis, such as to prove that he or she made a particular payment. [Alternative 1: A bank that responds to the consumer's request by providing a substitute check must provide the required disclosure at the time the consumer requests the copy.] [Alternative 2: A bank that responds to the consumer's request by providing a substitute check must provide the required disclosure no later than the time at which it provides that substitute check.]

b. 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 depositary bank returns the check to the depositor in the form of a substitute check. A depositary bank that provides a returned substitute check to a consumer depositor must provide the substitute check disclosure at that time, unless it has given such disclosure previously.

51. In appendix E, in newly-redesignated paragraph XXXVII, revise paragraph A.1. to read as follows:

* * * * *

XXXVII. 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.

* * * * *

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

XXXVII. * * *

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.

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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. * * *

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7. *Model C–5A.*

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

* * * * *

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

XXXVII. * * *

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. * * *

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11. *Models C–22 through C–25 generally.* Models C–22 through C–25 provide models for the various notices required when a customer 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; therefore, use of these models may, but will not necessarily, be deemed compliance with the requirements of § 229.54(e).

12. *Model C–22 Full Refund Notice.* A bank may use this model when crediting the entire amount of a customer's expedited recredit claim within ten days of the customer submitting the claim or when crediting the remaining amount of a customer's expedited recredit claim by the 45th calendar day after the customer submitted the claim, as required under § 229.54(e)(1).

13. *Model C–23 Partial Refund Notice.* A bank may use this model when crediting a partial expedited recredit to a customer, pending further investigation of the claim, as required under § 229.54(e)(1).

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

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

* * * * *

54. 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, December 22, 2003.

Jennifer J. Johnson,

Secretary of the Board.

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