

Complying With Expedited Funds Availability Without Losing Your Shirt

By Edward F. Donohue

Many bankers view Regulation CC with apprehension because of the risks associated with complying with the regulation before good funds can be confirmed. However, the regulation has a number of built in safeguards designed to limit a bank's exposure as an involuntary lender to the kitters, forgers and counterfeiters.

A. What Are Low Risk Checks?

Your tellers and other operations personnel need orientation on which checks genuinely qualify for next day availability. Kitters and other bad guys often hedge their bets that a depository bank will not differentiate. Thus, they often deposit items known to clear more slowly precisely to give themselves more lead time. Generally only government checks, cashier's checks and checks from your state and processing region qualify for the quickest one and two day schedules. The first two are easy to identify, as are the second two from the micra encoding if not the face of the check. Other items may be held according to sensible risk management parameters established by the bank.

B. How Do I Protect Myself in the Case of Government Checks and Cashier's Checks? Pick up the Phone.

If a depository bank sits back and relies on the loss minimizing features of the Regulation to avoid loss it can die the slow death of a thousand \$5,000 cuts in the form of

altered and counterfeit out-of-state cashier's checks and treasury checks. The answer – pick up the phone.

A cashier's check is not a three-party item. As a result, the opportunity to obtain definitive confirmation on the bonafides of the item are better. Once the check is endorsed, it is just you and your sister bank. Even if you can not get a straight answer from a confused teller 3,000 miles away as to the validity of the item, that is fine. That puts you squarely within the discretionary hold provisions described below.

Treasury checks are a bigger problem because, under Regulation J, the Treasury has never been willing to establish a firm deadline for return of an altered or counterfeit item. Treasury affords itself a "reasonable time" after its first inspection to return the item, by which time even the non-local and high risk deadlines may pass.

The Treasury has steadily increased security to prevent alterations and counterfeits. All branches would be well-served to have an ultraviolet light scanner available to check for the ultraviolet image on large items. It is also virtually impossible to raise or bleach without producing obvious signs or tampering. There are still some techniques which work if carefully undertaken such as slicing the dollar box to raise the amount.

Detailed information on how to spot counterfeit government checks is provided on the Secret Service website, <http://www.treas.gov/uss/money>. To authenticate a suspicious Treasury check a bank may contact the Financial Management Service Check Claims Division at 1-800-826 9434 or the claims office for the Regional Financial Center from which the check is issued. Most state governments provide similar security services

and some states, such as Pennsylvania have implemented a Positive Pay program to electronically verify treasury checks.

C. The \$5,000 Cutoff

Even in the case of low risk and local checks it is important to keep in mind that the maximum exposure on next day availability can be limited to \$5,000 inclusive of all checks deposited on that banking day. It is generally not feasible to sustain a sizeable kite or other fraudulent scheme given this limitation. In view of the time limitations on settlement and return applicable to payor banks, the depository bank can generally place a longer hold on all items within a day or two of the first uncollectible item. If a bank avails itself to the \$5,000 limit with respect to customers who do not thoroughly satisfy the “know your customer” standard, it is much better situated to avoid large losses. Few crooks are willing to risk federal penitentiary sentences for low multiples of \$5,000.

D. Discretionary Holds

A banker should keep the policies behind Regulation CC in perspective when considering the potential flexibility afforded under Section 229.13. The government was concerned with arbitrary and uniform and arbitrary discrimination against certain classes of customers. The standard is framed in terms of a “well-grounded belief in the mind of a reasonable person” that the item is uncollectible. Although Appendix E to the Rule outlines some obvious examples of reasonable cause to suspect uncollectibility, there is the examples are not intended as exhaustive list. Thus, there is no evidence that the regulators second-guess any individual hold unless it falls into suspicious repetitive and potentially discriminatory patterns. The examiners are after all concerned with the safety and soundness of the system as a whole. A banker should not turn a blind eye to any

indicia of untrustworthiness. Ultimately the discretionary hold standard has been relegated to the banker's good judgment. The consequences of being overly cautious and wrong, at best, may bring regulatory review of no moment except in the case plainly unjustifiable holds. The consequences of extending credit on an uncollectible item will go right to the bottom line.

E. The Deadlines

Low Risk	Next day
Local	Second day
Non-Local	Fifth day
High Risk / Excess of \$5,000	Add five days for local, six days or more for non-local if reasonable

F. Identify an Operations Officer to Learn the Finer Points of the Regulation

The foregoing provides an overview the more significant safeguards under Regulation CC to minimize the risks associated with returned checks. It does not cover all forms of deposit items nor the myriad of specialized rules governing the exact starting point of the availability deadlines which can vary greatly depending on how the item was deposited (See § 229.19). There are also certain availability exceptions beyond the scope of this article such as those related to new accounts, redeposited items, etc. (See § 229.13). Moreover, wading through the various disclosure requirements of the Regulation is a formidable task. These numerous and often less familiar details underscore the need to appoint a senior operations officer to become thoroughly familiar with the Regulation and provide guidance to all depository side personnel.

Moreover, the flip side of Regulation CC, the obligations of the payor bank, can pose a mine field with even greater and more subtle traps for the unwary. Some banks have so badly miscalculated their deadlines in the past that virtually every returned item was returned late. The issue of late return goes beyond the scope of this article and indeed is very difficult to treat both accurately and briefly. For a good overview of the subject contact Robert Mulford, former General Counsel for the Federal Reserve Bank in San Francisco and ask for Bob's excellent article, '**Round Midnight**'. Bob is currently a member of the Friedemann, O'Brien, Goldberg & Zarian, LLP firm in Santa Rosa, Telephone No.: (707) 541-7200; E-Mail: rmulford@fozlaw.com

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