

**FEDERAL RESERVE SYSTEM**

**12 CFR Part 229**

**Regulation CC; Docket No. R-1564**

**RIN 7100 AE 78**

**Availability of Funds and Collection of Checks**

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Proposed rule, request for comment.

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**SUMMARY:** The Board is proposing to amend Regulation CC to address situations where there is a dispute as to whether a check has been altered or is a forgery, and the original paper check is not available for inspection. The proposed rule would adopt a presumption of alteration for any dispute over whether the dollar amount or the payee on a substitute check or electronic check has been altered or whether the substitute check or electronic check is derived from an original check that is a forgery. This rule is intended to provide clarity as to the burden of proof in these situations.

**DATES:** Comments must be submitted by [date 60 days following publication in the Federal Register].

**ADDRESSES:** You may submit comments, identified by Docket No. R-1564 by any of the following methods:

- *Agency Web site:* [http:// www.federalreserve.gov](http://www.federalreserve.gov). Follow the instructions for submitting comments at <http://www.federalreserve.gov/apps/foia/proposedregs.aspx>.
- *Email:* [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov). Include the docket number in the subject line of the message.
- *FAX:* (202) 452–3819 or (202) 452– 3102.
- *Mail:* Ann E. Misback, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue N.W., Washington, DC 20551.

All public comments are available on the Board's Web site at <http://www.federalreserve.gov/apps/foia/proposedregs.aspx> as submitted, except as necessary for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room 3515, 1801 K Street N.W. (between 18th and 19th Street N.W.), Washington, DC 20006 between 9:00 a.m. and 5:00 p.m. on weekdays.

**FOR FURTHER INFORMATION CONTACT:** Clinton N. Chen, Attorney (202/452-3952), Legal Division; or Ian C.B. Spear, Senior Financial Services Analyst (202/452-3959), Division of Reserve Bank Operations and Payment Systems; for users of Telecommunication Devices for the Deaf (TDD) only, contact 202/263-4869; Board of Governors of the Federal Reserve System, 20th and C Streets NW., Washington, DC 20551.

**SUPPLEMENTARY INFORMATION:**

**I. Statutory and Regulatory Background**

Congress enacted the Expedited Funds Availability Act of 1987 (EFA Act) to provide prompt funds availability for deposits in transaction accounts and to foster improvements in the check collection and return processes. Section 609(c) authorizes the Board to regulate any aspect of the payment system and any related function of the payment system with respect to checks in order to carry out the provisions of the EFA Act.<sup>1</sup>

Regulation CC implements the EFA Act. Subpart C of Regulation CC implements the EFA Act's provisions regarding forward collection and return of checks.

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<sup>1</sup> EFA Act section 609(c)(1) states that “[i]n order to carry out the provisions of this title, the Board of Governors of the Federal Reserve System shall have the responsibility to regulate—(A) any aspect of the payment system, including the receipt, payment, collection, or clearing of checks; and (B) any related function of the payment system with respect to checks.” 12 U.S.C. 4008(c)(1).

## II. UCC Provisions Regarding Altered and Forged Checks

Under the Uniform Commercial Code (UCC), an alteration is a change to the terms of a check that is made after the check is issued that modifies an obligation of a party by, for example, changing the payee's name or the amount of the check.<sup>2</sup> By contrast, a forgery is a check on which the signature of the drawer (i.e., the account-holder at the paying bank) was made without authorization at the time of the check's issuance.<sup>3</sup> In general, under UCC 4-401, the paying bank may charge the drawer's account only for checks that are properly payable.<sup>4</sup> Neither altered checks nor forged checks are properly payable. In the case of an altered check under the UCC, the banks that received the check during forward collection, including the paying bank, have warranty claims against the banks that transferred the check (e.g., a collecting bank or the depository bank). In the case of a forged check, however, the UCC places the responsibility on the paying bank for identifying the forgery.<sup>5</sup> Therefore, the depository bank typically bears the loss related to an altered check, whereas the paying bank bears the loss related to a forged check.

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<sup>2</sup> UCC 3-407. The UCC is a uniform body of laws promulgated by the American Law Institute and the Uniform Law Commission, which may be enacted by state legislatures. Article 3 addresses payment by check and other negotiable instruments while Article 4 addresses bank deposits.

<sup>3</sup> The term "forgery" is not defined in the UCC. However, the term "unauthorized signature" is defined as "a signature made without actual, implied, or apparent authority" and "includes a forgery." UCC 1-201(41).

<sup>4</sup> The term "bank" as used in this notice and in Regulation CC (12 CFR 229.2(e)) includes a commercial bank, savings bank, savings and loan association, credit union, and a U.S. agency or branch of a foreign bank.

<sup>5</sup> The presenting bank warrants to the paying bank only that it has no knowledge of an unauthorized drawer's signature. *See* UCC 3-417 and 4-208.

These provisions of the UCC reflect the long-standing rule set forth in *Price v. Neal* that the paying bank must bear the loss when a check it pays is not properly payable by virtue of the fact that the drawer did not authorize the item.<sup>6</sup> The *Price v. Neal* rule reflects the assumption that the paying bank, rather than the depositary bank, is in the best position to judge whether the drawer's signature on a check is the authorized signature of the account-holder. By contrast, the depositary bank is arguably in a better position than the paying bank to inspect the check at the time of deposit and detect an alteration to the face of the check, to determine that the amount of the check is unusual for the depositary bank's customer, or to otherwise take responsibility for the items it accepts for deposit.

### **III. Proposed Presumption of Alteration**

Regulation CC does not currently address whether a check should be presumed to be altered or forged in cases of doubt. For example, an unauthorized payee name could result from an alteration of the original check that the drawer issued, or from the creation of a forged check bearing the unauthorized payee name and an unauthorized/forged drawer's signature. Courts have reached opposite conclusions as to whether a paid, but fraudulent, check should be presumed to be altered or forged in the absence of evidence (such as the original check).<sup>7</sup> Since the time of these decisions, the check collection system has become overwhelmingly electronic, and the number of instances in which the original paper check is available for inspection in such cases will be quite low.<sup>8</sup> Unlike the 2006 court cases, where the paying bank received and

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<sup>6</sup> *Price v. Neal*, 97 Eng. Rep. 871 (K.B. 1762).

<sup>7</sup> See, e.g., *Chevy Chase Bank v. Wachovia Bank, N.A.*, 208 Fed. App'x. 232, 235 (4th Cir. 2006) and *Wachovia Bank, N.A. v. Foster Bancshares, Inc.*, 457 F.3d 619 (7th Cir. 2006).

<sup>8</sup> For example, by the beginning of 2017 the Federal Reserve Banks received over 99.99 percent of checks electronically from 99.06 percent of routing numbers and presented over 99.99 percent of checks electronically to over 99.76 percent of routing numbers. As of the same time, the

destroyed the original check, in today's check environment the original check is typically truncated by the depository bank or a collecting bank before it reaches the paying bank. In light of requests from members of the industry, the Board requested comment on the adoption of an evidentiary presumption in Regulation CC.<sup>9</sup> Specifically, the Board requested comment on whether it should adopt an evidentiary presumption, and if yes, whether the check should be presumed to be altered or forged in cases of doubt.<sup>10</sup> The Board also requested comment on whether banks are aware of or have information pertaining to whether forged checks are a more common method of committing fraud than altering the payee name or amount on the check.

The Board received four comments concerning the adoption of an evidentiary presumption.<sup>11</sup> All four, including a comment letter submitted by a group of institutions and trade associations, supported the adoption of an evidentiary presumption of alteration in the event that there is insufficient evidence to determine whether a particular check was altered or is a forged item. One commenter believed that a presumption of alteration (imposing the risk of loss on the depository bank as described above) is appropriate in today's virtually all-electronic environment. The commenter reasoned that in today's environment the vast majority of checks

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Federal Reserve Banks received 99.63 percent of returned checks electronically from over 99.37 percent of routing numbers and delivered 99.41 percent of returned checks electronically to 92.84 percent of routing numbers.

<sup>9</sup> Although the Board did not raise the issue, two commenters requested that the Board address the uncertainty caused by the divergent appellate court decisions in response to a 2011 proposed rulemaking. 76 FR 16862 (March 25, 2011). The Board describes these comments in greater detail as part of its 2014 proposal. 79 FR 6673, 6703 (Feb. 4, 2014).

<sup>10</sup> The Board believes that the substance of the UCC's loss-allocation framework for altered and forged checks, under which the depository bank generally bears the loss for altered checks and the paying bank generally bears the loss for forged checks, continues to be appropriate in the current check-processing environment.

<sup>11</sup> The Board received an additional comment about the applicability of the UCC to alterations by persons other than the payee. The commenter did not address whether the Board should adopt an evidentiary presumption.

are truncated by the depository banks or their customers, the depository bank has the option of retaining the original check, and if the depository bank presents a substitute check, the paying bank does not have the right to demand presentment of the original check.

Based on these comments, the Board is proposing to adopt a presumption of alteration with respect to any dispute arising under federal or state law as to whether the dollar amount or the payee on a substitute check or electronic check has been altered or whether the substitute check or electronic check is derived from an original check that is a forgery. The Board requests comment on whether the presumption should also apply to a claim that the date was altered.

Under the proposed rule, the presumption of alteration may be overcome by a preponderance of evidence that the substitute check or electronic check accurately represents the dollar amount and payee as authorized by the drawer, or that the substitute check or electronic check is derived from an original check that is a forgery. The proposed rule would also state that the presumption of alteration shall cease to apply if the original check is made available for examination by all parties involved in the dispute. The Board requests comment on whether the presumption of alteration should apply if the bank claiming the presumption received and destroyed the original check.

The Board is also proposing accompanying commentary provisions to explain the operation of the rule, including clarification that the presumption does not alter the process by which a bank may seek to make a claim against another bank on a check that the bank alleges to be altered.

#### **IV. Competitive Impact Analysis**

The Board conducts a competitive impact analysis when it considers an operational or legal change, if that change would have a direct and material adverse effect on the ability of

other service providers to compete with the Federal Reserve in providing similar services due to legal differences or due to the Federal Reserve's dominant market position deriving from such legal differences. All operational or legal changes having a substantial effect on payments-system participants will be subject to a competitive-impact analysis, even if competitive effects are not apparent on the face of the proposal. If such legal differences exist, the Board will assess whether the same objectives could be achieved by a modified proposal with lesser competitive impact or, if not, whether the benefits of the proposal (such as contributing to payments-system efficiency or integrity or other Board objectives) outweigh the materially adverse effect on competition.<sup>12</sup>

The Board does not believe that the proposed amendments to Regulation CC will have a direct and material adverse effect on the ability of other service providers to compete effectively with the Reserve Banks in providing similar services due to legal differences. The proposed amendments would apply to the Reserve Banks and private-sector service providers alike and would not affect the competitive position of private-sector presenting banks vis-à-vis the Reserve Banks.

## **V. Paperwork Reduction Act**

In accordance with the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3506; 5 CFR part 1320 Appendix A.1), the Board may not conduct or sponsor, and a respondent is not required to respond to, an information collection unless it displays a valid Office of Management and Budget (OMB) control number. The Board reviewed the proposed rule under the authority delegated to the Board by the OMB and determined that it contains no collections of information

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<sup>12</sup> Federal Reserve Regulatory Service, 7-145.2.

under the PRA.<sup>13</sup> Accordingly, there is no paperwork burden associated with the rule.

## **VI. Regulatory Flexibility Act**

The Regulatory Flexibility Act (the “RFA”) (5 U.S.C. 601 *et seq.*) requires agencies either to provide an initial regulatory flexibility analysis with a proposed rule or to certify that the proposed rule will not have a significant economic impact on a substantial number of small entities. In accordance with section 3(a) of the RFA, the Board has reviewed the proposed regulation. In this case, the proposed rule would apply to all depository institutions. This Initial Regulatory Flexibility Analysis has been prepared in accordance with 5 U.S.C. 603 in order for the Board to solicit comment on the effect of the proposal on small entities. The Board will, if necessary, conduct a final regulatory flexibility analysis after consideration of comments received during the public comment period.

### *1. Statement of the Need for, Objectives of, and Legal Basis for, the Proposed Rule.*

The Board is proposing the foregoing amendments to Regulation CC pursuant to its authority under the EFA Act. The proposal addresses situations where there is a dispute as to whether a check has been altered or is a forgery, and the original paper check is not available for inspection. The check collection system has become overwhelmingly electronic, and the number of instances in which the original paper check will be available for inspection in such cases will be quite low. Under the UCC, the depository bank typically bears the loss related to an altered check, whereas the paying bank bears the loss related to a forged check. The proposed rule would adopt a presumption of alteration with respect to any dispute as to whether the dollar

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<sup>13</sup> See 44 U.S.C. 3502(3).

amount or the payee on a substitute check or electronic check has been altered or whether the substitute check or electronic check is derived from an original check that is a forgery.

*2. Small Entities Affected by the Proposed Rule.*

The proposed rule would apply to all depository institutions regardless of their size.<sup>14</sup> Pursuant to regulations issued by the Small Business Administration (13 CFR 121.201), a “small banking organization” includes a depository institution with \$550 million or less in total assets. Based on call report data as of December 2016, there are approximately 10,185 depository institutions that have total domestic assets of \$550 million or less and thus are considered small entities for purposes of the RFA.

*3. Projected Reporting, Recordkeeping, and Other Compliance Requirements.*

A presumption of alteration shifts the burden to the bank that warrants that a check has not been altered, which could be a depository bank or collecting bank. In order to overcome the proposed presumption of alteration, a depository bank or collecting bank must prove by a preponderance of evidence that either the substitute check or electronic check accurately represents the dollar amount and payee as authorized by the drawer, or that the substitute check or electronic check is derived from an original check that is a forgery. Under the proposed rule, the presumption of alteration shall cease to apply if the original check is made available for examination by all parties involved in the dispute.

A depository bank or collecting bank that destroys all original checks after truncation may incur additional risk, as it may not be able to overcome the presumption of alteration. The Board expects depository banks and collecting banks to weigh the costs and benefits of

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<sup>14</sup> The proposed rule would not impose costs on any small entities other than depository institutions.

destroying or retaining original checks, such as for large dollar amounts, so that the presumption of alteration will not apply.

*4. Identification of Duplicative, Overlapping, or Conflicting Federal Rules.*

As mentioned above, courts have reached opposite conclusions as to whether, under the Uniform Commercial Code, a paid, but fraudulent, check should be presumed to be altered or forged in the absence of evidence, such as the original check. The proposal would resolve that discrepancy under the conditions described above. The Board knows of no other duplicative, overlapping, to conflicting Federal rules related to this proposal.

*5. Significant Alternatives to the Proposed Rule.*

As discussed above, the Board requested comment as part of its 2014 Regulation CC proposal on whether it should adopt an evidentiary presumption, and if so, whether the check should be presumed to be altered or forged in cases of doubt.<sup>15</sup> All comments received supported the adoption of an evidentiary presumption of alteration. The Board welcomes comment on the impact of the proposed rule on small entities and any approaches, other than the proposed alternatives, that would reduce the burden on all entities, including small issuers.

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<sup>15</sup> 79 FR 6673, 6703 (Feb. 4, 2014).

**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 proposes to amend 12 CFR part 229 as follows:

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

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

**Authority:**

12 U.S.C. 4001-4010, 12 U.S.C. 5001-5018.

2. In § 229.38, paragraph (i) is added to read as follows:

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**Subpart C—Collection of Checks**

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**§229.38 Liability.**

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(i) *Presumption of Alteration.* (1) *Presumption.* Subject to paragraph (i)(2), the presumption in this paragraph applies with respect to any dispute arising under federal or state law as to whether—

(i) the dollar amount or the payee on a substitute check or electronic check has been altered or

(ii) the substitute check or electronic check is derived from an original check that is a forgery.

When such a dispute arises, there is a rebuttable presumption that the substitute check or electronic check contains an alteration of the dollar amount or the payee. The presumption of alteration may be overcome by proving by a preponderance of evidence that either the substitute check or electronic check accurately represents the dollar amount and payee as authorized by the drawer, or that the substitute check or electronic check is derived from an original check that is a forgery.

(2) *Effect of producing original check.* If the original check made available for examination by all parties involved in the dispute, the presumption in paragraph (i)(1) shall no longer apply.

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3. In Appendix E to part 229, under “XXIV. Section 229.38 Liabilities,” add new paragraph “I. 229.38(i) Presumption of Alteration”

The addition reads as follows:

**Appendix E to Part 229—Commentary**

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***XXIV. Section 229.38 Liability***

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*I. 229.38(i) Presumption of Alteration*

1. This paragraph establishes an evidentiary presumption of alteration of a check when the original check has been converted to an image and only an electronic check or a substitute check is available for inspection. This provision does not alter the transfer and presentment warranties under the UCC that allocate liability among the parties to a check transaction with respect to an altered or forged item. The UCC or other applicable check law continues to apply with respect to other rights, duties, and obligations related to altered or forged checks.

2. The presumption of alteration applies when the original check is unavailable for review by the banks in context of the dispute. If the original check is produced, through discovery or other means, and is made available for examination by all the parties, the presumption no longer applies. There is no presumption of alteration as between two banks that exchange an original check.

By order of the Board of Governors of the Federal Reserve System, May 26, 2017.

Ann E. Misback (signed)  
Ann E. Misback,  
Secretary of the Board.