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CRS Report for Congress

Expedited Funds Availability/Check-Holds

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Summary

In 1987, Congress passed the Expedited Funds Availability Act,[1] which addresses the check-hold policies of depository financial institutions for various types of transaction accounts. The act assures timely access to deposited funds and requires institutions to disclose their funds availability policies to customers. Federal Reserve Regulation CC implements the funds availability provisions and includes a schedule with maximum time limits for withholding funds.

The enactment of P.L. 108-100, the Check 21 Act,[2] refocused attention on the check-hold policies of financial institutions. The act, which became effective on October 28, 2004, makes it easier for financial institutions to convert paper checks into electronically generated images, and has the potential of making the clearing process between institutions faster and more efficient. The law does not require institutions to generate or receive check images, but they must accept a substitute check created from an electronic image. Consumer advocates are concerned that the implementation of Check 21 will result in money clearing out of accounts faster without speeding up the availability of funds deposited into accounts. Check 21 required the Federal Reserve to study and evaluate the impact of the act on the clearing process. The Federal Reserve issued a report to Congress on the results of its study in April of 2007. This CRS report provides information on the current Regulation CC provisions, the issues raised by the Check 21 Act, and the Federal Reserve's findings. This report will be updated as events and legislation warrant.

Background

The intent of the Expedited Funds Availability Act (EFAA) of 1987 was twofold: first, to ensure that account holders have timely access to deposited funds; and second, that depository financial institutions provide clear disclosure about check hold policies to their customers. The practice of placing holds on accounts was developed to protect

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[1] P.L. 100-86; 101 Stat.563.

[2] 117 Stat.1177.

an institution in the event a deposited check was returned unpaid. Provisions of the 1987 act addressed the need for improvements in the check collection and return system to counter the effect of reduced hold periods.

The potential costs to account holders from lengthy hold periods and insufficient disclosure of hold policies provided the impetus for this legislation. During a hold period, customers are unable to make withdrawals by check or other means against those deposited funds on which the hold was placed. If a financial institution receives a check written against an account before the hold is lifted and the account has insufficient funds because of the hold, it can choose to cover the check and charge the customer an "overdraft" fee. Alternatively, the institution can return the check without paying it and charge the account holder a "bounced check" or "nonsufficient funds" fee. The third party check recipient may charge the account holder an additional "returned check" fee. As it is possible for more than one check to be presented during the hold period, the fees can accumulate quickly.

The Federal Reserve's Regulation CC[3] implements the EFAA. Regulation CC applies to all transaction accounts (as defined by Federal Reserve Regulation D) and it extends to both consumer- and business-held deposit accounts. Check holds are not required. Check hold policies can vary within the restraints of maximum time frames which are outlined in a schedule. The regulation also provides for longer hold periods under "exception" situations. Regulation CC contains rules for disclosure of funds availability policies and to expedite the return of unpaid checks by institutions.

The schedule is measured in business days following the banking day of deposit, and all references are to the maximum number of days that a financial institution can hold a check deposit. The first $100 of any check deposit must be made available the first business day following the day of deposit. Several types of check deposits are subject to "next-day availability," which means that funds must be available the first business day following the banking day of deposit. In this category are U.S. Treasury checks and the following checks when deposited in person: cashier's, certified, or teller's checks, U.S. Postal Service money orders, Federal Reserve Bank or Federal Home Loan Bank checks, state or local government checks, and checks drawn on an another account held by that institution ("on-us checks"). The time period is extended when deposits are made at an ATM (automated teller machine). If the ATM is owned by the account holder's financial institution, the funds must be available by the second business day. Deposits made at ATMs owned by other institutions must be available by the fifth business day.

In general, if a check is not subject to "next day availability" the clearing schedule (except for the first $100) depends on whether the check is local or nonlocal. If the account holder's institution is in the same check processing region as the paying institution,[4] the check is local. Funds deposited by local checks must be made available for withdrawal by the second business day and alternatively, funds from nonlocal checks must be made available by the fifth business day.

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[3] For the full text of Regulation CC, see [http://www.federalreserve.gov/regulations/default.htm].

[4] Party responsible for making the payment of the amount written on a check.

Regulation CC also permits financial institutions to impose "exception" holds for certain types of deposits or accounts. Included in the exception category are large deposits (greater than $5,000), redeposited checks, deposits to accounts repeatedly overdrawn, when the institution has a reasonable cause to doubt the collectibility of the check, emergency conditions, and new accounts (open less than 30 days). In general, the extended period of time for on-us checks is one additional business day (for a total of two days), for local checks five additional business days (for a total of seven days), and for nonlocal checks six additional business days (for a total of eleven days).

Regulation CC requires financial institutions to provide customers with a written disclosure of their funds availability policies prior to opening a transaction account. If the availability terms on an existing account are changed, the account holder must be provided with a new disclosure 30 days in advance unless the change expedites funds availability, in which case, notice may be given no later than 30 days after implementation. In addition, notices must be posted in each location where employees accept deposits and at all ATMs. The customer must be notified when an exception hold is placed on a deposit. Model disclosure statements are provided.

The regulation contains provisions to speed up the check return process in an effort to ensure that institutions are advised when a check is being returned before the deposited funds are made available. Options and methods are addressed in Subpart C of Regulation CC. In general, institutions are encouraged to use the most efficient path to route the return and to provide for the automated processing of returned checks. Finally, the Board of Governors of the Federal Reserve is directed by Section 603 (d) (1) of the EFAA to make reductions in the hold time periods established in Regulation CC as warranted by improvements in the check clearing system.

Ongoing Issues

The Check Clearing for the 21st Century Act (P.L. 108-100) was enacted on October 28, 2003, to foster innovation in the payments system and enhance its efficiency by facilitating the use of electronic check processing.[5] The implementation of the act, commonly referred to as Check 21, has raised concerns with the current check-hold time periods permitted by Regulation CC and whether they should be adjusted. Check 21 deals with the check collection process, and its purpose is to enable financial institutions to handle more checks electronically. Importantly, the law does not require institutions to adapt new collection procedures or generate digital check images. The law does require institutions to accept a new negotiable instrument, a paper "substitute check," created from the electronic information captured from the original paper check. It is anticipated that the Check 21 Act will not result in an immediate transformation, but instead the law will facilitate an evolutionary path away from a paper-based payments system. Therefore, the benefits from electronic check processing may not be immediately realized.

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[5] For more information, see CRS Report RL32668, *Electronic Banking: The Implementation of the Check 21 Act*, by Walter W. Eubanks and CRS Report RS22525, *Electronic Banking: The Post-Check 21 Payments System*, by Walter W. Eubanks.

Provisions of Check 21 required the Federal Reserve to conduct a study and issue a report to Congress on current funds availability policies (appropriateness of time periods), whether the schedule in Regulation CC reflects the current needs of financial institutions (are institutions routinely clearing checks faster), should the amount of the large check exception be raised, and the impact of the new law on hold periods. The report would address any recommendations for legislative action.

Consumer advocates have raised several issues with Check 21. A major concern is that the electronic check processing facilitated by this act will greatly reduce the time it takes to deduct money from a customer's account, but won't affect the account holder's access to the deposited funds. Therefore, they argue, the benefits from the increased use of electronic processing will accrue mainly to banks. Legislation (H.R. 799) to address this potential imbalance was introduced in the 109th Congress on February 15, 2005. No further action was taken on the bill. The legislation would have amended the Expedited Funds Availability Act to reduce the maximum time frames for hold policies. Other adjustments addressed in the legislation included raising the threshold for large check exceptions from $5,000 to $7,500, treating Saturday as a business day if accounts are debited on Saturdays, and requiring institutions to process credits before debits.

The issue of whether funds availability schedules should be shortened was debated at a subsequent oversight hearing held on April 20, 2005. The Subcommittee on Financial Institutions and Consumer Credit of the House Committee on Financial Services held a hearing on the implementation of the Check 21 Act.[6] The Federal Reserve testified that material improvements from Check 21 had not yet been realized. The expectation was for gradual change as banks invest in new check processing technologies over time. In addition, the lead time for the operational and technical preparations necessary to use new payments services also slows the pace of implementation.

The banking industry representatives testifying agreed with the Federal Reserve that the transition to electronic check processing will be evolutionary not revolutionary. The provisions of Check 21 facilitate a gradual and orderly change. In addition, check hold policies continue to provide important protections against check fraud. The funds availability schedules should not be shortened until the check processing system is operating more efficiently.

The consumer advocate testified that the Check 21 Act and advances in technology have facilitated more efficient check processing. Changes to the funds availability schedules should not have to wait until the vast majority of checks are processed electronically. Congress was urged to reduce check holds by amending the EFAA if the Federal Reserve's 2007 report did not recommend changes in hold times.

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[6] The printed hearing can be viewed at [http://financialservices.house.gov/archive/hearings.asp@formmode=detail&hearing=374.html].

April 2007 Report

In April 2007, the Federal Reserve submitted a report to Congress on the effects of the Check 21 Act on the nation's check collection system.[7] In March 2006, the Board of Governors of the Federal Reserve System conducted a survey of the banking system to assess whether there had been sufficient improvement in the check collection and return system to support changes to the funds availability schedules. Based on the survey findings and other research gathered by the Board, the Board recommended making no changes to the current funds availability policies.

At the time of the survey Check 21 had been in effect for 17 months. The March 2006 survey identified a slow-paced adoption of Check 21 by financial institutions. The survey results indicated approximately 93% of all checks paid involved a paper check.[8] The Federal Reserve's report did state that by January 2007 the nation's banking industry had experienced a significant increased use of electronics to collect and present checks for payment. The report also concludes that Check 21 is an important catalyst for potential change, but much broader adoption of new technologies and processes must occur before check return times can decline appreciably.

The report also addressed the effect of the consolidation of the Federal Reserve's check-processing sites on check holds. The Federal Reserve has begun a program of reducing the check-processing infrastructure in response to declining check volumes. When check-processing regions are combined into one larger region the result is a change in the classification of a number of deposited checks from nonlocal to local. This reclassification reduces the maximum permissible hold periods for that volume of checks now deemed local. The report stated that additional consolidations are expected.

Finally, the Board will continue to monitor the check collection and return system and will use its existing authority, consistent with EFAA, to reduce funds availability schedules when the evidence warranted. The Board of Governors of the Federal Reserve is directed by Section 603 (d) (1) of the EFAA to make reductions in the hold time periods established in Regulation CC as warranted by improvements in the check clearing system.

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[7] Board of Governors of the Federal Reserve System, "Report to the Congress on the Check Clearing for the 21st Century Act of 2003," April 2007. This report can be viewed at [http://www.federalreserve.gov/boarddocs/RptCongress/check21pdf].

[8] Ibid. p.10.