NOTES

BANK CHECK-HOLD POLICIES: A PROPOSAL TO PROTECT CONSUMERS

INTRODUCTION

Few people know[1] that American banks may hold[2] a check[3] for as long as it takes to receive verification of payment from the bank on which it was drawn.[4] Despite this, Americans wrote approximately forty billion checks in 1984.[5] The check-hold policy has its basis in the length of time it takes to transfer the funds between the banks involved. In some areas of the country, banks hold depositor's funds for up to four weeks.[6] Payment to the bank, however, is guaranteed in two business days if the bank belongs to the Federal Reserve System.[7] Banks use this float period[8] to increase profits at the expense of their customers.

Banks and financial institutions claim they must hold checks for certain periods of time because the drawer's checking account balance may be

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1. *See* Gross, *How Consumer American Views the Financial Services Industry*, AM. BANKER, Oct. 23, 1984, at 2. Only 37% of Americans polled knew that their banks had check-hold policies.
2. In this note, hold refers to a depository institution's delay in providing access to a customer's funds. A customer's check is held in the sense that the financial institution has possession and control of the check.
3. Checks may be defined in various ways. This note will consider checks in the broadest manner, so as to include more than personal checks. *See* 12 C.F.R. § 210.2(f) (1985) (defines check as a draft, as defined in U.C.C. § 3-104 (1978), which discusses forms of negotiable instruments). Each check has a grouping of numbers that gives it an individual identity. The coded numbers allow computer tracking of the check to the specific customer. *See* R. CURRIE, CHECK CLEARING—PROFIT OR LOSS 134 (1974) (coded numbers specify the Federal Reserve District; branch, city, state or region within the Federal Reserve District; payor's bank and its approximate location; and payor's account number).
4. *See Delayed Funds Availability: Hearings Before the Subcommittee on Consumer Affairs of the Senate Committee on Banking, Housing and Urban Affairs*, 97th Cong., 2d Sess. 170 (1982) [hereinafter cited as *Delayed Funds Availability Hearings*].
5. *See* STAFF OF HOUSE OF REPRESENTATIVES SUBCOMMITTEE ON DOMESTIC MONETARY POLICY OF THE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS, 98TH CONG., 2d SESS., THE ROLE AND ACTIVITIES OF THE FEDERAL RESERVE SYSTEM IN THE NATION'S CHECK CLEARING AND PAYMENTS SYSTEM 61 (Comm. Print 1984) [hereinafter cited as ROLE OF FEDERAL RESERVE IN CHECK CLEARING].
6. A survey authorized by the Federal Reserve Board found that out-of-town checks may be held for 21 business days, which is longer than four weeks. *See Delayed Funds Availability Hearings*, *supra* note 4, at 1-2 (statement of Sen. Chafee).
7. The maximum period for deferral of credit is presently two business days after which the member bank's reserve account is automatically credited. BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, THE FEDERAL RESERVE SYSTEM: PURPOSES AND FUNCTION 49 (7th ed. 1985) [hereinafter cited as FEDERAL RESERVE SYSTEM].
8. Float is a term that describes the amount of funds tied up in checks that have been written and are being processed but have yet to be collected. J. WESTON & T. COPELAND, MANAGERIAL FINANCE 1035 (8th ed. 1986).

insufficient.[9] Banks return, however, only seven checks for every thousand checks written.[10] Commentators disagree about whether this is a reasonable method of protecting the banks,[11] or simply a scheme to increase bank profits.[12] Consumer advocate groups have been pushing for reforms.[13] In response, five states have enacted laws advocating a reduction in the check-hold period,[14] and fifteen others are considering similar legislation.[15] Moreover, Congress has proposed several bills that would shorten the length of time for check holds.[16]

This note focuses on check-hold policies of depository institutions. It demonstrates that banks profit by using customers' funds without compensating depositors. The note analyzes state laws recently enacted in California and New York, as well as proposed federal legislation. Finally, the note proposes alternative solutions to the check-hold problem.

THE CHECK-CLEARING PROCESS

In the United States, money[17] takes the form of currency or checking

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9. *See Fair Deposit Availability Act: Hearings on S. 573 Before the Subcommittee on Consumer Affairs of the Senate Committee on Banking, Housing and Urban Affairs*, 97th Cong., 1st Sess. 38 (1983) (statement of D. Lee Falls, Vice President, Bank of America, San Francisco) [hereinafter cited as *Fair Deposit Availability Act Hearings*].
10. *See* BANK ADMINISTRATION INSTITUTION, THE IMPACT OF EXCEPTION ITEMS ON THE CHECK COLLECTION SYSTEM 23 (1974). *See also* U.C.C. § 4-212, Comment 1 (1978). "Under current bank practice . . . banks make provisional settlement for [checks] when they are first received . . . . Statistically, this practice of settling provisionally first and then awaiting final payment is justified because more than ninety-nine per cent of such cash items are finally paid . . . ."
11. *See generally* Wechsler, *Delayed Funds Availability*, 35 SYRACUSE L. REV. 1117 (1984) (banks assert that they must have check-hold policies because of the potential for lost funds due to bad checks).
12. *See* Naylor, *Congressmen Say They'll 'Bounce' Check-hold Policies*, AM. BANKER, Oct. 10, 1985, at 3.
13. *See* Trigaux, *Check Hold Policies Are Still 'Unfair', Survey by Consumer Group Concludes*, AM. BANKER, Apr. 23, 1985, at 16; Hooper, *Pressure Remains to Improve California Hold Periods*, AM. BANKER, Apr. 29, 1985, at 122.
14. CAL. COMM. CODE § 4213 (West Supp. 1986), 1985 Conn. Acts 194 (Reg. [Spec.] Sess.) (recently enacted legislation that has yet to be codified); MASS. ANN. LAWS ch. 167D § 34 (Law. Co-op. Supp. 1986); N.Y. BANKING LAW § 14(d)(2) (McKinney 1987); R.I. GEN. LAWS §§ 4-601-608 (1985).
15. Arkansas, Colorado, Florida, Hawaii, Illinois, Maine, Montana, Nevada, New Jersey, North Carolina, Oklahoma, Pennsylvania, South Carolina, Texas and Washington. *See The Expedited Funds Availability Act*, H.R. 2443, 99th Cong., 1st Sess. 18 (1985). H.R. 2443 was reintroduced to Congress as H.R. 28 by House Banking Chairman Fernand J. St Germain on January 6, 1987. The bill retains similar provisions with longer hold schedules than the original.
16. *The Fair Deposit Availability Act of 1984*, S. 2851, 98th Cong., 2d Sess. (1984); *The Expedited Funds Availability Act*, H.R. 5301, 98th Cong., 2d Sess. (1984); *The Fair Deposit Availability Act of 1983*, H.R. 4187, 98th Cong., 1st Sess. (1983); *The Fair Deposit Availability Act of 1983*, S. 573, 98th Cong., 1st Sess. (1983); *Delayed Funds Availability: Hearings Before the Subcommittee on Consumer Affairs of the Senate Committee on Banking, Housing and Urban Affairs*, 97th Cong., 2d Sess. (1983).
17. The Uniform Commercial Code defines money as a medium of exchange authorized or adopted by a domestic or foreign government as a part of its currency. U.C.C. § 1-201(24) (1978). The concept of money has been expanding and now must include electronic money, such as debit and credit cards.

accounts.[18] Essential to check usage is the acceptance of the check as a method of payment. The check-clearing process starts with the payee's exchange of the check for money. The check is cleared by transferring it from the payee's bank to the drawer's bank.

The check clearing system processes forty billion checks per year[19] and brings together customers, commercial banks,[20] savings associations[21] and the Federal Reserve.[22] The purpose of the system is to expeditiously carry a check from the depositor's bank to the drawer's bank.[23] After the check has been deposited, it goes through one of two processes. If the drawn check and the depositing bank are the same, the bank credits the check. If the drawn check comes from another bank, it must be returned to the drawer's bank.

The depositor's bank may send the check directly to the drawer's bank with the banks settling their own accounts. Alternatively, the bank may use a clearinghouse[24] to sort the checks received and distribute them to the drawer's bank. That bank then credits the depositor's bank.

The final alternative[25] is the Federal Reserve System, which maintains supervisory power over the nation's banks.[26] Member banks of the Federal Reserve System comprise approximately forty percent of the commercial banks in the United States[27] and account for seventy percent of all bank deposits.[28] Member banks[29] have access to facilities for collecting checks, settling clearing balances, and transferring funds by wire.[30] Commercial banks send checks for processing to either the Federal Reserve banks or their branches.[31] Upon arrival, the Federal Reserve marks the checks to determine when the depositing bank will receive credit. This may be one

18. *See* ROLE OF FEDERAL RESERVE IN CHECK CLEARING, *supra* note 5, at 1-4.
19. *See id.* at 61.
20. Commercial banks are institutions authorized to receive demand and time deposits, to make loans of various types, to engage in trust services and other fiduciary funds, to issue letters of credit, to accept and pay drafts, to rent safety deposit boxes, and to engage in many similar activities. They are the only institutions authorized to receive demand deposits. *See* U.S. v. Philadelphia National Bank, 201 F. Supp. 348, 360 (1962).
21. A savings association is "a cooperative association that uses money deposited by a closed group of persons and lends it out again to persons in the same group at favorable interest rates." BLACK'S LAW DICTIONARY 332 (5th ed. 1979). The most common example of a savings association is a local savings and loan that mainly lends money for real estate purchases.
22. *See* FEDERAL RESERVE SYSTEM, *supra* note 7, at 1. The Federal Reserve System provides for an elastic currency, facilitates discounting paper and supervises banking functions. *See id.* at 20.
23. *See* ROLE OF FEDERAL RESERVE IN CHECK CLEARING, *supra* note 5, at 7-10.
24. *See* U.C.C. § 4-104(d) (1978) ("Clearinghouse means any association of banks or other payor regularly clearing items").
25. *See generally* ROLE OF FEDERAL RESERVE IN CHECK CLEARING, *supra* note 5.
26. *See* FEDERAL RESERVE SYSTEM, *supra* note 7, at 90.
27. *See id.* at 9 (in 1983, 5,700 commercial banks out of 15,000 were member banks).
28. *See id.*
29. *See* 12 U.S.C. §§ 371-378 (1986) (describing the powers and duties of member banks).
30. *See* FEDERAL RESERVE SYSTEM, *supra* note 7, at 106-10.
31. *Id.* at 20-22. *See also* 12 U.S.C. § 222 (1986). Federal Reserve banks are in Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas and San Francisco. The Federal Reserve has branches in Buffalo, Cincinnati, Pittsburgh,

or two business days.[32] The depositing bank's account receives automatic credit. Non-member banks using the Federal Reserve System's check-clearing process must make a deposit with a correspondent member bank.[33]

In 1984, the Federal Reserve cleared about sixteen billion checks.[34] Through this clearinghouse function, the Federal Reserve attempts to make funds available to depositors as soon as possible. Member banks in the same Federal Reserve city obtain immediate credit for checks deposited with them. Checks not meeting the immediate credit requirement receive deferred credit.[35] Deferral of credit lasts a maximum of two days, at which time the Federal Reserve automatically credits the member bank's reserve account.[36]

In 1972, the Federal Reserve System created Regional Check Processing Centers to increase the efficiency of the check clearing process.[37] With the increase in collection points, the number of checks cleared on an immediate credit basis has risen dramatically.[38] The Regional Check Processing Centers accelerate acceptance of checks drawn on banks within the same Federal Reserve zone, but not within the same Federal Reserve city.[39] The Regional Check Processing Centers gather checks in the afternoon and evening and deliver checks for payment the next day.[40] The increased efficiency of the check processing system results in a reduction of float.

Use of float creates the opportunity for banks to employ check-hold schemes. Banks can create float at each step in the check-clearing process. Three principal types of float exist: Federal Reserve float, commercial banking float and customer float.[41] Federal Reserve float occurs when a check has been credited by a Federal Reserve bank, but payment of the check from the drawer's bank has not been made.[42] Member banks

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Baltimore, Charlotte, Birmingham, Jacksonville, Miami, Nashville, New Orleans, Detroit, Little Rock, Louisville, Memphis, Helena, Denver, Oklahoma City, Omaha, El Paso, Houston, San Antonio, Los Angeles, Portland, Salt Lake City and Seattle.

32. *See* 12 U.S.C. § 360 (1986). *See also* 12 C.F.R. § 210.1 (1985) (discussing collection of checks and other items and transfers of funds).
33. *See* 12 U.S.C. § 342 (1986) (non-member banks may use the Federal Reserve System through member banks, provided the non-member bank maintains a specified balance with the Federal Reserve bank).
34. *See* ROLE OF FEDERAL RESERVE IN CHECK CLEARING, *supra* note 5, at 61.
35. *See* FEDERAL RESERVE SYSTEM, *supra* note 7, at 49.
36. *See* 12 C.F.R. § 210.11 (1985) (the Federal Reserve bank shall give immediate or deferred credit in accordance with its two-day time schedule).
37. *See* BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, THE FEDERAL RESERVE SYSTEM: PURPOSES AND FUNCTION 21 (6th ed. 1974) [hereinafter cited as PURPOSES AND FUNCTIONS].
38. *See id.* at 21 (prior to regional check processing centers, only 19% of the checks were given immediate credit; by 1973, 56% of the checks were cleared immediately).
39. *See* R. CURRIE, *supra* note 3, at 31 (the regional check processing center program expands previous zones of overnight clearing in the nation's check system).
40. *See id.* at 32.
41. *See id.* at 37.
42. The difference between the asset account (cash items in process of collection) and the liability account (deferred availability cash items) represent checks that, although not yet collected by

realize a net gain by using funds for which they have not yet paid. Commercial bank float occurs when the dollar volume credited to member accounts has not been collected from those banks.[43] Finally, customer float arises when a customer writes a check and the bank has not deducted the amount of the check from that person's account.[44] All three floats exist because of delays in the physical movement of checks through the clearing process. Increased technology, mostly notably electronic funds transfer,[45] reduces delays that cause float problems.[46]

BANK USE OF CHECK-HOLD FUNDS

Though instrumentalities of the federal government, states can exert control over national banks,[47] provided such control does not conflict with federal law.[48] All states have adopted Article IV of the Uniform Commercial Code as a guideline for the banking industry.[49] Article IV requires banks to return checks by a midnight deadline or within a "reasonable time" after the bank learned the drawing account had nonsufficient funds.[50] The "reasonable time" requirement allows banks to use delay tactics that prevent customers from receiving their funds at the earliest possible time.[51]

Since the Federal Reserve guarantees the checks within a two-day period, banks have use of customers' money before checks clear the system. By using the float that this lag time creates, banks profit on money that

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the reserve banks, have previously been credited to the reserve accounts of the banks that deposited them. *See* FEDERAL RESERVE SYSTEM, *supra* note 7, at 106-107.

43. *See* R. CURRIE, *supra* note 3, at 41.
44. *See id.* at 44.
45. Electronic funds transfer is a general name applied to electronic banking. It includes, but is not limited to, computerized payment services, automated deposit and withdrawal services, electronic deposit of salary and social security checks, and payment of bills without cash or checks.
46. For a discussion of electronic funds transfer in the banking industry, *see* A. LIPIS, T. MARSHALL & J. LINKER, ELECTRONIC BANKING 4 (1985).
47. National banks are instrumentalities of the federal government, created for public purposes and subject to the authority of the United States. Smith v. Witherow, 102 F. 2d 638 (3d Cir. 1939). The objective of a national banking law was to provide uniform and secure currency and to facilitate operations of the United States Treasury. Mercantile Bank v. New York, 121 U.S. 138 (1887). National banks are not subject to state contol. States may not affect their operation in any manner, except as Congress permits. Farmers' & Mechanics' Nat'l Bank v. Dearing, 91 U.S. 29 (1875).
48. *See* Rushton v. Schram, 143 F.2d 554 (6th Cir. 1944) (national banks are immune from any state control that conflicts with laws of the United States).
49. *See* U.C.C. XLIII-IV (1978) (table of jurisdictions wherein code has been adopted). *See also Fair Deposit Availability Act Hearings, supra* note 9, at 37 (statement by P. Martin, Vice Chairman, Board of Governors of the Federal Reserve System).
50. U.C.C. § 4-212 (1978). A bank must return the check "by its midnight deadline or within a longer reasonable time after it learns the facts it returns the item or sends notification of the facts."
51. *See* Hooper, *supra* note 13, at 31 (reference to Ralph Nader's United States Public Interest Research Group study of 669 banks in 10 states concerning excessive delays with check holds).

rightfully belongs to the customer.[52] Giving customers the use of their money when the bank has use of the funds would solve the dilemma and alleviate this hardship on customers.[53] Consumers often encounter difficulties because banks hold checks while using the float on those checks.[54] When the bank waits a specified time period, it may place the customer in the precarious position of explaining to creditors why his or her check bounced. The customer may be futher aggrieved if the bank charges him for writing checks with insufficient funds.

Traditionally, banking has been depicted as a slow, stodgy industry, reluctant to change. Deregulation of the banking industry[55] combined with the expanded capabilities of brokerage houses has created numerous choices for consumers. To compete, banks must change their policies.[56] Indeed, the check-float issue may be an area in which banks may wish to voluntarily change their policies to attract customers.[57] First, a change toward a more consumer-oriented policy could slow the momentum for proposed legislation that could place far more stringent restrictions on the banking industry. Second, banks would avoid government regulations. Finally,

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52. *See Delayed Funds Availability Hearings, supra* note 4, at 24. (Sen. Dodd estimated the value of one day's float in 1982 to be about $1 billion.) *See also* Wechsler, supra note 10, at 1158 n.246 (estimates of float revenues vary and have been calculated at $3.5 billion per year).
53. Check holds cause problems for consumers, especially for those relocating. These consumers need funds immediately to pay moving expenses, but may wait up to three weeks because of bank policy. *See Fair Deposit Availability Act Hearings, supra* note 9, at 37 (testimony of Ellen Broadman, Counsel for Government Affairs, Consumers Union).
54. *See id.* at 92-105 (testimony of Gale Essary, representing People, Inc.) (Most consumer difficulties center on depositing a check one or two days before the person must pay a bill. The consumer believes he or she has sufficient funds to cover payment of the bill, but later discovers that the bank did not clear the deposited check).
55. *See generally* Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132. Since passage of this act, the banking industry has experienced increased competition from other institutions that are now permitted to engage in activities traditionally reserved for banks.
56. *See Fair Deposit Availability Act Hearings, supra* note 9, at 202-16 (report by Florida Public Interest Research Group providing statistics on the various bank check-holding periods in Dade County, Fla.). Check-hold policies are bank estimates for determining whether a check was dishonored. As the check-hold statistics of banks in Dade County, Fla., show, different banks have different hold periods. *See id.* at 202-16. *See also Delayed Funds Availability Hearings, supra* note 4, at 2 (statement of Sen. Chafee: "[W]e . . . found many institutions have hold policies that are very generous to their customers. I seriously question why, if these institutions can maintain such policies without undue losses, others cannot as well.").
57. The customer, whether an individual or a corporation, remains the most important element for the bank. Banks have traditionally relied on the word of mouth of satisfied customers as the major means by which new customers are drawn to the bank. As a solution to the check float problem, banks could offer, as a marketing device, to credit a customer's account within a reduced period of time. Since banks perform essentially the same functions, a bank that offers customers the advantage of reduced float time could attract more customers. *See Delayed Funds Availability Hearings, supra* note 4, at 67. W.J. Heron, Jr., Senior Vice President of Citibank, said the banking industry has "long been aware of the importance of prompt cash availlability to our customers. In fact, we consider it to be an important element in the rigorous fight for the consumer dollar in New York." *Id.* at 67.

customers would receive their money without any loss of interest due to check-hold delays.

The preceding short-term solutions could be instituted by banks immediately. Banks have adamantly refused to change their position regarding check float, however, and they have lost customers to financial institutions that provide similar services, along with services in which banks cannot engage.[58]

The banking industry claims check holds are necessary to prevent fraud.[59] Even though the bank receives provisional credit from the Federal Reserve for checks deposited,[60] the bank waits a certain period of time before crediting the depositor's accounts.[61] Banks have developed a system calculating the amount of time normally required for a check to be returned for insufficient funds.[62] The time periods reflect the past statistical data concerning bad checks. Banks claim to take this wait-and-see approach because they cannot determine that a check is bad until it is returned. If returned checks constituted a major problem, this action would appear warranted. The percentage of checks returned, however, is so small that critics argue the check-hold policy results in unjust enrichment to the banking industry.[63]

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58. *See generally* J. COOPER, V. DILORENZO & W. SCHLICHTING, BANKING LAW (1985). Since the passage in 1933 of the Glass-Steagall Act, prohibiting banks from dealing in securities (except government bonds), the securities business has consisted of a relatively separate and well-defined group of firms. However, with the increasing tendency for individuals to make equity investments indirectly through institutions, rather than trading directly in stock for their own account, securities firms have come increasingly into competition with banks and insurance companies, particularly with respect to the management of pension funds. This competition has placed severe strains on the existing regulatory structure, under which securities firms, banks and insurance companies are regulated by different agencies with entirely different concerns and approaches. *See also* G. WILLIAMS, FINANCIAL SURVIVAL IN THE AGE OF NEW MONEY, 146, 175 (1982) (discussing movement of customers from commercial banks to savings and loan associations; Merrill Lynch and American Express can perform banking-type functions while being involved with the securities market).
59. *See Fair Deposit Availability Act Hearings, supra* note 9, at 145. (testimony of J. Hatch, President, Canaan National Bank, for the American Banker's Association: "Such a policy would leave institutions wide open to check kiters . . . .").
60. *See* FEDERAL RESERVE SYSTEM, *supra* note 7 at 49. Provisional credit is the Federal Reserve's credit to a bank's account before check funds have been received from the drawer's bank. The Federal Reserve automatically provides provisional credit after two business days. *See id.* at 49. Banks have provisional credit from the time the account is automatically credited until the bank receives actual credit. *See id.* at 49.
61. *See The Expedited Funds Availability Act, supra* note 16, at 159 (statement of C.T. Conover, Comptroller of the Currency, that banks never know if a deposited item has been cleared; therefore, financial institutions hold checks for variable lenghts of time until it is likely a check has cleared).
62. *See Fair Deposit Availability Act Hearings, supra* note 9, at 142, 145, 169 (testimony of J. Hatch, President, Canaan National Bank, for the American Banker's Association; statement of D.L. Falls, Vice President, Bank of America for the Consumer Banker's Association) (banks claim they do not know how long it may take to return a check; therefore, they estimate this time period and incorporate it into their check-hold policies).
63. *See supra* notes 10 and 11 and accompanying text.

STATE LEGISLATION

In 1983, California instituted changes in the check-holding process.[64] California set several guidelines that come into effect depending on the origin of the check. For commercial banks, the maximum hold period is based on the location of the depositor's bank and the drawer's bank.[65] Checks drawn on a thrift institution and deposited in a commercial bank generally have longer hold periods than commercial bank checks.[66]

Prior to the law, California banks had check-hold periods of up to three weeks.[67] By 1985, check holds averaged no more than five business days.[68] Although this law has helped consumers, its benefit becomes apparent only when compared to previous check-hold periods.[69]

New York also enacted legislation in 1983 limiting check-hold periods.[70] The provisions laid down by the New York State Banking Board resemble the California regulations. The New York law contains a distinction between commercial banks and savings institutions. The law allows savings banks longer hold periods.[71] The law provides a few exceptions: one-day availability on checks less than $100,[72] and special treatment for deposits more than $2,500,[73] deposits by new customers,[74] and customers who have overdrawn frequently in the past.[75] Finally, the New York law permits depository institutions and customers to agree to a longer hold period than the regulations allow.[76]

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64. CAL. COMM. CODE § 4213 (West Supp. 1986) (law controls the time period for which banks may hold checks in California).
65. The following hold periods are allowed for commercial banks: one business day for a check drawn on a depository bank or any office of the bank; two business days for a check drawn on a local bank; three business days on any payor bank in California and that is deposited in an account at a city depository bank; four business days for a check that is drawn on any payor bank in California and is deposited at a bank other than a city depository bank; eight days for an out-of-state check deposited at a bank other than a city depository bank. CAL. COMM. CODE § 4213 (West Supp. 1986).
66. *Id.* § 4213. The following hold periods are allowed for thrift institutions: four business days for a check drawn on a California thrift and deposited at a city depository bank; five business days for a check from a California thrift to a non-city depository bank; nine business days for an out-of-state thrift and a non-city depository bank. If the check was from a credit union, one extra day is added to the above specifications. Whether the banks involved are city banks (located in San Francisco or Los Angeles) also affects the hold period.
67. *See* Hooper, *California Banks Assail New Float Rules as Too Stringent,* AM. BANKER, Oct. 18, 1984, at 22.
68. *See* Hooper, *supra* note 13, at 3. Banks can hold out-of-state checks for the maximum 10-day period.
69. Although the law reduces check-hold periods, banks will still play the float game because provisional credit is given within two business days.
70. N.Y. BANKING LAW § 14(d)(2) (McKinney 1987).
71. N.Y. BANKING LAW § 14(d) (McKinney 1987).
72. N.Y. ADMIN. CODE tit. 3, § 34 (McKinney 1984). *See also* Weinstein, *New York State Check-Holding-Limit Rule Takes Effect,* AM. BANKER, Mar. 8, 1984, at 3 (statement by Richard J. Riley, public information officer, N.Y. State Banking Department).
73. *See* N.Y. ADMIN. CODE tit. 3, § 34 (McKinney 1984).
74. *See* N.Y. ADMIN. CODE tit. 3, § 34 (McKinney 1984).
75. *See* N.Y. ADMIN. CODE tit. 3, § 34 (McKinney 1984).
76. *See* N.Y. BANKING LAW § 14(d) (McKinney 1987) ("this section does not prohibit a banking institution and a retail banking customer from agreeing in writing to a greater period of time . . . .").

As in California, New York's legislation has successfully reduced check-hold periods without adversely affecting depository institutions.[77] By reducing the check-hold periods and preventing large losses due to bad checks, both pieces of legislation have struck a sound compromise between customer and institution.

Even at the reduced levels, banks can profit from the float game. Any time a customer's account does not receive credit after the bank has been given provisional credit[78] on the deposited check, the bank gains on the use of the float. Depending on the day of deposit, the hold period could last nineteen days.[79] A similar criticism of the recent California law can be applied to the New York law. Both laws fall short of crediting customer's accounts when the depository institution receives provisional credit. Banks in both states continue to profit through check float.

Recent state legislation reflects the growing concern over check-float usage by banks. The success of the California and New York regulations demonstrates the usefulness of legislation action. Although desirable, changes by state legislatures do not provide a complete solution to check-hold problems. Only federal legislation would force the entire banking industry to comply.

PROPOSED FEDERAL LEGISLATION

Although the check-hold problem affects many people[80] and the Federal Reserve Board sees it as an important issue,[81] Congress has yet to act. Critics dismiss the need for national legislation, stating that bank regulators should control the destiny of the issue.[82] Increased public awareness of

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77. Eighty-one percent of the New York banks did not suffer any losses from bad checks and the other banks had minimal losses. *See News Release: Banking Superintendent Reports No Significant Losses Due To Check Availability Regulation*, N.Y.S. BANKING DEP'T., June 3, 1985; *See also* Sudo, *Report: Shorter Check Holding Not Hurting Institutions in NY*, AM. BANKER, Sept. 6, 1984, at 2. *See also Expedited Funds Availability Act*, *supra* note 14, at 17 (statement by Jill M. Considine, New York State Superintendent of Banks).

78. *See supra* note 60 and accompanying text.

79. Theoretically, a check deposited on a Friday would not be available until the third Monday from that Friday. The bank would have five business days for the first Monday to Friday and five more business days for the second week. Not until the nineteenth day after depositing the check could the customer use his funds. The Uniform Commercial Code defines a business day as a banking day. U.C.C. § 4-104 (1978). ("Banking day means that part of any day on which a bank is open to the public for carrying on substantially all of its banking functions").

80. *See* Garsson, *Fed Criticized on Check Hold*, AM. BANKER, Jan. 27, 1987, at 1, 14 (Rep. McKinney, R-Conn., stated that nothing irritated his constituency more than check holds). *Id.* at 14. *See also Fair Deposit Availability Act Hearings*, *supra* note 9, at 124-25. (according to Federal Reserve Board figures, more than 10 million people have had problems with check holds).

81. *Id.* at 125 (testimony of Ellen Broadman, Counsel for Government Affairs, Consumers Union) (according to the Federal Reserve, delayed funds is an issue that "comes right to the top as an area that is most complained about").

82. *See* Weschler, *supra* note 10, at 1182-91, 1214 (stating that the solution lies in improving the return trip process of checks).

the problem, combined with effective state legislation, has pressured Congress to consider enactment of comprehensive legislation. The Expedited Funds Availability Act (H.R. 2443), which passed the House in 1985 and was reintroduced as H.R. 28 in 1987, recognizes that the depository institutions cannot regulate themselves.[83] The bill would place a time limit on how long depository institutions may withhold the availability of funds owed to the depositor.[84] Four sections of the bill would affect the banking industry and consumers.

Section three would require the Federal Reserve System to develop a national expedited funds availability system.[85] During the three-year implementation period, the Federal Reserve would file progress reports to the Banking Committee every six months[86] and file a special report at the end of two years.[87] The section also would direct the Federal Reserve to investigate the feasability of a uniform check-endorsement standard[88] and the potential for direct notification of non-payment.[89]

Ninety days after enactment of the legislation, section four's timetable for the availability of funds from certain types of deposits would become operative.[90] This section requires next day availability for checks less than $100, checks drawn on in-state branches of the receiving depository institu-

83. *See supra* note 15 and accompanying text (discussing the reintroduction of H.R. 2443 as H.R. 28). *See also St Germain Reintroduces Delayed Funds Availability Legislation*, [Jan.-June] WASH. FIN. REP. (BNA) No. 44, at 832 (May 13, 1985). St Germain complained that his bill "is in part necessitated by inaction" of the groups involved with check clearing. *Id.*

84. *See Expedited Funds Availability Act. supra* note 15, at 2.

> It is the purpose of this Act to—(1) adopt temporary, maximum time limits for the availability of funds deposited by check; (2) replace those temporary time limits with standard availability ceilings within 3 years after the effective date of section 4; (3) require depository institutions to fully disclose their funds availability policies to depositors; (4) permit States, and individual depository institutions to adopt funds availability policies which allow depositors to gain access to funds earlier than prescribed by Federal law or regulation; and (5) prescribe appropriate enforcement mechanisms to ensure compliance with the provisions of this Act.

Id. § 2(b), at 2.

85. "The Board of Governors of the Federal Reserve System shall immediately begin to develop an expedited funds availability sytem which will meet the funds availability schedule . . . ." *Id.* § 3, at 2.

86. *Id.* § 3(e)(1), at 3 (the Federal Reserve Board would transmit a progress report to both houses of Congress every six months until a new availability system had been implemented).

87. *Id.* § 3(e)(2), at 3 (the Federal Reserve Board would report to both houses of Congress about the effects of temporary schedules set forth in § 4 after a two-year period).

88. *See Fair Deposit Availability Act Hearings, supra* note 9, at 154-60. The American National Standards Institute has proposed a national standard for check endorsements. The American National Standards Institute standard would divide the back of a check into four endorsement areas: (1) first reader/sorter; (2) subsequent reader/sorter; (3) encoders, microfilmers; and (4) payee endorsements. *Id.* at 154-60. The American National Standards Institute requires that the printing of various check-clearing organizations be put into separate zones to prevent overlap. Inefficient manual handling is required when a computer cannot read jumbled print and the American National Standards Institute system would reduce this problem. *Id.*

89. *See Expedited Funds Availability Act. supra* note 15, at 19. In developing such a system, the Federal Reserve is directed to consider, among other things, establishing a system for expedited unpaid check returns, a uniform endorsement standard and direct notification of non-payment.

90. *See id.* § 4, at 3 (section discusses some of the proposed methods that prevent check-hold delays).

tion, and certain types of federal, state and local checks.[91] An interim time schedule differentiating between local and non-local checks would remain in effect until complete implementation of section three's provisions.[92]

The bill would also require depository institutions to disclose their check-hold policies to customers in accordance with section nine.[93] Banks would have thirty days to notify their customers by mail, display notice in bank lobbies and print notices on automated teller machine[94] deposit slips.[95]

Section five would allow exceptions to sections three and four in specific instances.[96] For example, an exception to compliance would occur during the first thirty days after opening an account.[97] To avoid check-kiting schemes, sections three and four would not apply to an account overdrawn three times in any six-month period.[98] As a further means of preventing

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91. *See id* § 4(c)(2), at 3. Funds deposited in an account at a depository institution by check shall be available on the business day after the business day on which such funds are deposited. Also covered by the bill would be checks from the same state, as well as federal, state and local checks drawn on federal, state and local treasuries.

92. *Id.* § 4(c)(3), (4), at 4.

> Not more than 2 business days shall intervene between that business day on which funds are deposited in an account at a depository which funds are deposited by a check drawn on a local originating depository institution and the business day on which such funds are available for withdrawal . . . . Not more than 6 business days shall intervene between the business day on which funds are deposited in an account at a depository institution by a check drawn on a nonlocal originating depository institution and the business day on which such funds are available for withdrawal.

Id.

> For local checks, during the first year after enactment, funds will become available within three business days and within two business days in the second and third years.
> Not more than one business day shall intervene between the business day on which funds are deposited in an account at a depository institution by a check drawn on a local originating depository institution and the business day on which such funds are available for withdrawal.

See id. § 4(d)(3), at 4.

Funds for non-local checks, for the first three years, will become available within seven business days. *Id.* § 4(d)(4), at 4.

93. *Id.* § 9, at 6-7. Banks would be required to disclose check-hold policies to their customers. Banks would also have to disclose information about hold periods for regional banks and have employees capable of providing such information. *Id.* at 6-7.

94. *See* A. LIPPIS, T. MARSHALL & J. LINKER, *supra* note 46, at 7. Automatic teller machines are computerized bank tellers that perform limited functions. They are attractive to the banking industry because of their cost efficiency. Their convenience has resulted in increasing acceptance by the public.

95. *See Expedited Funds Availability Act, supra* note 15, § 9(c), (d), at 7.

96. *Id.* § 5, at 4-5. §§ 3 and 4 of the bill will not apply to new accounts, unless there was less than $5,000 in cashier's or certified checks involved. On the ninth business day, checks over $5,000 would be available.

97. *Id.* § 5(a)(3), at 5. Wire-transfer funds and traveler's checks under $5,000 would be available the next business day.

98. *Id.* § 5(d), at 5.

> In any case in which, on three separate and distinct occasions within any 6-month period, any account or successor account as defined by the [Federal Reserve] Board, by regulation of a depositor has been the subject of checks which were written by such depositor and which were in excess of the available funds in the account involved sections 3(b), 4(c) and 4(d) shall not apply to any such account for a period of 6 months following the last occasion involved.

check-fraud losses, the Federal Reserve could issue a forty-five day suspension of the regulations if a bank were to suffer an unacceptable level of losses.[99] Section five serves as an appeasement to the banking industry's fears about check fraud.[100]

ALTERNATIVE LEGISLATION

H.R. 2443 has many positive aspects. Recognition of the Federal Reserve System as the appropriate instrument to solve customers' check-hold problems represents the most significant feature of this legislation.[101] The Federal Reserve has the capacity to rectify the nationwide abuse of check-hold float. As a federally chartered body dealing in check-clearing activities across the country,[102] the Federal Reserve System has the expertise to institute the mandated changes.

Check-hold problems exist nationwide, so an effective solution can come only through national legislation. H.R. 2443 moves in the right direction but does not go far enough. The Federal Reserve System should have plenary power over depository institutions in the check-clearing process. By fully utilizing the Federal Reserve System, the proposed legislation could lay the foundation for future growth through the increased use of computer technology.[103] Reliance on such technology depends on uniformity among the processes involved.

The Federal Reserve System clears checks from across the country with a two-day guarantee on check funds. If all banks joined as member banks for purposes of check clearing, consumers could have access to their funds as soon as most depository institutions currently do.[104] Economically, banks

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99. *Id.* § 5(g), at 5.

> The [Federal Reserve] Board may, by regulation or order, suspend the applicability of this Act, or any portion thereof, to any classification of checks [that] the Board determines . . . . No regulation prescribed or order issued under paragraph (1) shall remain in effect for more than 45 days (excluding Saturdays, Sundays, legal holidays, or any day either House of Congress is not in session).

100. Section five's Safeguard Amendments reasonably soothe the banking industry's fears about check fraud. The 30-day exception for new accounts appears equitable to the customer and the bank. The exception allows the bank to determine the riskiness of the new account and does not unreasonably disadvantage the customer. This clause would provide protection a bank might need if it faced a particular problem with check fraud. If too many losses were to occur, the suspension period allows investigation of the trouble without overburdening the bank.

101. *See Expedited Funds Availability Act, supra* note 15, at 2. *See also supra* note 84 and accompanying text.

102. *See supra* notes 31-33 and accompanying text.

103. As a national institution, the Federal Reserve System is capable of creating a uniform computer-based system. The present diversity in check-clearing technologies mandates this uniformity for an efficient and effective national system.

104. The credit card industry presently verifies credit by telephone. The card number is fed into computer data banks to determine creditworthiness of the card holder. *See also Fair Deposit Availability Act Hearings, supra* note 9, at 145 (testimony of J. Hatch, President, Canaan National Bank, for the American Bankers Association).

should use the Federal Reserve System because check processing costs would be significantly reduced.[105]

When a customer deposits a check, the length of delay the check receives relates to the location and the nature of the depository institution. The disparate treatment of bank, thrift and money market checks illustrates the need for putting those depository institutions under a uniform system. Confusion about check-hold periods for different types of checks would diminish, along with depository institutions' excuses for long delays.

H.R. 2443, however, fails to grant the Federal Reserve System power to cause change. Section three allows for only the possibility of uniform endorsement standards and the chance of direct notification.[106] To be effective, the bill must do more than allow for the possibility of change—it must specify that change will come.

Use of the American National Standards Institute code[107] would increase the efficiency of the check-clearing process by eliminating much of the manual handling of returned checks.[108] Direct notification of non-payment provides depository institutions with another alternative for remedying the check-hold problem. Determination of the funds' availability could be established by a telephone credit check between the institutions involved. The technology to implement direct notification could be borrowed from the credit card industry's verification procedures.[109] With direct notification of non-payment, banks could not float funds while waiting to see if a check will be returned.[110]

To improve the bill, Congress should shorten H.R. 2443's allowable seven-day period for out-of-state checks. Banks receive provisional credit within two days;[111] therefore, the legislation should use a two-day hold period. The Act also suffers because section four allows three years for implementation of the total program.[112] As a major clearinghouse, the Federal Reserve could implement these changes rapidly. The Federal Reserve

105. Industry sources claim that it costs 24 cents per check for normal check processing. The Federal Reserve System processes checks for three cents per check. Saving 19 cents per check should be a strong incentive for banks to join the Federal Reserve System. *See* ROLE OF FEDERAL RESERVE IN CHECK CLEARING, *supra* note 5, at 61.

106. *See Expedited Funds Availability Act, supra* note 15, § 3(c), at 2 (stating that the Federal Reserve shall consider developing different systems, but only after establishing the expedited funds availability system that Congress has set forth).

107. *See supra* note 88 and accompanying text.

108. *See Fair Desposit Availability Act Hearings, supra* note 9, at 154-60. The American National Standards Institute system would divide the backs of checks into sorting zones, making it easier to read the information on checks. Uniform endorsement through the American National Standards Institute system would clarify the processing codes on the back of checks and allow faster movement of returned checks. Because the zones would be readable, electronic readers could sort the return process of the checks. This would be faster than having a person decipher lines printed on top of each other.

109. *See supra* note 104 and accompanying text.

110. *See supra* note 104 and accompanying text.

111. *See supra* note 7 and accompanying text.

112. *See supra* note 15 and accompanying text.

System and the banking industry, which have become adept at incorporating new technology in recent years, could adjust to the new legislation in one year.

By requiring next-day availability of checks less than $100,[113] H.R. 2443 greatly alleviates the check-hold problem, because most checks are for less than $100.[114] The small amount of the check ensures that banks will not suffer heavy losses. That the disclosure requirements of section nine fail to reduce check-hold periods is a major error in the bill.[115] Section nine creates consumer awareness of the check-hold problem but does not increase the availability of depositor's funds. This section fails a cost-benefit analysis: depository institutions will pass the expenses of notification on to their customers, while customers will not benefit from the disclosed information.

FUTURE SOLUTIONS BASED ON FEDERAL LEGISLATION

Although the best solution to the check-hold problem, national legislation is not the sole alternative. Short-term and voluntary solutions have some utility,[116] but substantial change will require the Federal Reserve have broad authority in the check-clearing process. The long-range outlook for the Federal Reserve System must be based on electronic technology. The use of electronic funds transfer systems[117] has revolutionized the banking industry and created alternatives to present methods of banking. Thanks to a computer-based network, the manual handling of checks in the clearing process may cease.[118]

Electronic funds transfer systems can provide for settlement of ac-

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113. *See Expedited Funds Availability Act, supra* note 15, § 4(c)(2), at 3.
114. Eighty percent of the checks flowing through New York institutions are written for less than $100. In New York, which has similar requirements for checks less than $100, the state law has successfully balanced customers' interest in quick access to their funds and banks' concerns about high losses. *See* N.Y.S. BANKING DEP'T. *supra* note 77. Nationally, more than 60% of the checks returned to banks for insufficient funds are for less than $100, and more than one-half of these are paid when presented the second time. *See* ROLE OF FEDERAL RESERVE IN CHECK CLEARING, *supra* note 5, at 59.
115. *See Expedited Funds Availability Act, supra* note 15, § 9, at 6-7.
116. *See supra* notes 54-59 and accompanying text.
117. AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, AUDIT CONSIDERATIONS IN ELECTRONIC FUNDS TRANSFER SYSTEMS 1 (1978). Electronic funds transfers are payment systems in which the processing and communications to effect economic exchange are dependent, wholly or in large part, on the use of electronics.
118. Automated teller machines are an integral part of electronic funds transfers, and automated teller machines are creating greater acceptance of computer technology with the public. *See* P. MARTIN, JR., AN INTRODUCTION TO ELECTRONIC FUNDS TRANSFER SYSTEMS 122 (1978). Automated teller machines are capable of handling such routine banking functions as deposits, withdrawals, transfers between accounts, bill paying and inquiries on account status.

counts between various financial institutions.[119] The Federal Reserve System has an automated clearinghouse system,[120] which enables high-speed processing of checks. The number of checks processed in the Federal Reserve System should expand to take full advantage of the efficient Federal Reserve clearinghouse. The increased productivity that electronic technology could afford the banking industry should not be wasted.

The credit card industry offers an example of another possible solution to the float problem.[121] Since a credit-check system is already in place for credit cards, the groundwork exists for expansion into the check-cashing process. When a person deposits a check with a bank, the bank could check the drawer's bank account to see if the person has sufficient funds to cover the check. The check amount can be recorded by the drawer's bank and the necessary funds frozen until the physical check arrives.

The computer-based system has numerous potential benefits, but disadvantages exist. The greatest concern to customers will be protection of privacy.[122] Electronic funds transfer systems can store vast amounts of information about an individual, creating concern about computer piracy of the data.[123] The success of a computer-based solution relies on closely guarding control over consumers' financial information. In considering the advantages and disadvantages of new technologies, Congress should not forget the potential of the Federal Reserve. Only through a national entity, such as the Federal Reserve System, will full implementation of computerization be possible.

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119. K. REICH, FUNDS TRANSFER SYSTEMS 11-12 (1983) (an automated clearinghouse takes in information from institutions and sorts the payment data electronically; check payment would consist of electronically crediting and debiting the accounts concerned).

120. 1 FED. BANKING L. REP. (CCH) ¶ 6203.101 (1984) (discussing function of automated clearinghouse arrangements).

121. When a customer uses his or her credit card, the magnetic tape on the card is scanned and transmitted via telephone lines to determine the customer's credit limit.

122. *See* AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, AUDIT CONSIDERATIONS IN ELECTRONIC FUNDS TRANSFER SYSTEMS 15 (1978). Many people are concerned with the unauthorized storage of and access to personal data.

123. *See* G. WILLIAMS, *supra* note 58, at 288-91. If a computer thief obtains a customer's banking card and personal identification number, the thief has total access to the customer's account. Although customers may oppose disclosure of their financial dealings, two Supreme Court cases support the right of depository institutions to retain such material. In California Bankers Assoc. v. Shultz, 416 U.S. 21 (1974), the Court upheld the Bank Secrecy Act of 1970 (Pub. L. No. 91-508, 84 Stat. 1114), which amended the Federal Deposit Insurance Act to require insured banks to maintain certain records and required that the Act's rules did not violate a depositor's fourth and fifth amendment rights. *Id.* at 55. Regulations requiring financial institutions to maintain records of their customers' identity and finance do not violate the fourth amendment rights of the bank nor those of the depositor. *Id.* at 52.

In United States v. Miller, 425 U.S. 435 (1976), the Court decided that the customer has no constitutionally protected interest in information the bank has possessed. *Id.* at 440-46. The Court decided that the customer gave the information freely, and it, therefore, became the property of the depository institution. Records of an individual's accounts with certain banks, records that the banks maintain in compliance with the record-keeping requirements of the Bank Secrecy Act of 1970, are not the individual's "private papers." *Id.* at 440.

CONCLUSION

Reliance on the Federal Reserve System would quiet consumer complaints about inordinate check holds for three reasons. First, since depository institutions receive provisional credit within two business days, fairness dictates that consumers' accounts should receive similar credit. Second, the Federal Reserve functions as a national clearinghouse. Expansion of its capabilities to encompass all depository institutions would increase the efficiency of the check-clearing process. Finally, with unification under one process, the potential exists for faster implementation of advances in computer technology. Electronic systems require compatability and uniform standards. To ensure that the check-clearing system keeps pace with computer technology, the Federal Reserve System must be used.

The prevalence of check-hold problems disturbs many critics, yet depository institutions remain entrenched in their position concerning check-hold delays. Customers endure this hardship, while depository institutions profit by use of consumer funds. Implementation of federal legislation adopting the Federal Reserve System as the entity governing the check-clearing process would prevent banks from profiting at the expense of customers.

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