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Credit Union Update

Regulation CC: A Review of Check Collection Procedures

By: Nicholas Albu

On February 27, 2010, the Federal Reserve will continue internal restructuring by transferring check-processing operations of the head office of the Federal Reserve Bank of Atlanta to the Federal Reserve Bank of Cleveland. The ultimate goal is a single check-processing region for purposes of the Availability of Funds and Collection of Checks (“Regulation CC”), where the distinction between local and non-local checks will no longer exist. Accordingly, the Federal Reserve will treat non-local checks as local and subject to faster availability schedules.

Virginia Credit Unions may realize an increase in fraudulent transactions because of earlier fund availability. With this in mind, certain provisions of Regulation CC Subpart C pertaining to check collection become increasingly important.

Consider the following scenario: A Credit Union member deposits a \$4,500 check into her account. As the depository institution, the Virginia-based Credit Union places a standard hold on the check and forwards it to the out-of-state payor institution. Upon receipt, the payor institution realizes the fraudulent nature of the check and determines not to pay it. However, the payor institution fails to provide timely, reasonable notice and expeditious return of the check, though the Federal Reserve ultimately handles the check for return. Unaware of these conditions, the depository institution pays the fraudulent check and the Credit Union member withdraws the entire balance and skips town. These unfortunate, yet plausible circumstances

raise a host of issues involving Regulation CC.

Overview of Regulation CC. The purpose of Regulation CC is to expedite the collection and return of checks by certain financial institutions, including Credit Unions. In doing so, Regulation CC establishes rules involving to return, notice, and liability. While Regulation CC supplements Virginia’s Commercial Code, it preempts inconsistent state law to the extent of the inconsistency.

Obligations Arising Under Regulation CC. Regulation CC currently requires the payor institution return the check in an expeditious manner, following either the Two-Day/Four-Day Test or the Forward Collection Test. Either test requires return of the check within a strict timeframe. Practical application of these regulations may be complicated by deadline computations, the legal meaning of “expeditious return,” and Virginia’s midnight deadline rule.

Regulation CC imposes additional obligations where the check involves an amount greater than \$2,500. In this case, the payor institution is obligated to provide reasonable notice of nonpayment, such that the depository institution receives notice by 4:00 p.m. (local time) on the second business day following the banking day on which the check was presented to the payor institution.

Liability Pursuant to Regulation CC. If the payor institution fails to exercise ordinary care or act in good faith in making timely return or providing reasonable, timely notice, it may be liable to

the depository institution for the loss incurred. Regulation CC caps liability at the amount of the check, reduced by the amount of the loss the depository institution would have incurred even if the payor institution had exercised ordinary care. However, Regulation CC reduces or even eliminates the payor institution's liability if its failure or delay is due to an act or omission of the depository institution.

Breach of transfer, settlement or encoding warranties may also carry liability. Damages may include an amount equal to the loss suffered because of the breach, but not more than the amount of the item, plus expenses and loss of interest incurred because of the breach.

Remedial Measures. Believing the payor institution did not provide notice or return, the depository institution may submit a Claim of Late Return. In handling this claim, the Federal Reserve will determine only that the claim is timely and substantially complete. While the Federal Reserve may provisionally credit the depository institution's account, the payor institution may reply by filing a response. The Federal Reserve will re-credit the payor institution's account upon a mere statement of timely return with supporting documentation.

The Federal Reserve offers these adjustments solely as a convenience to the institutions. Where there is further dispute, the Federal Reserve may instruct the parties to deal with each other directly. Assuming the parties are unable to resolve the matter themselves, either party may seek reconsideration. The Federal Reserve will respond to this request with an actual investigation, as opposed to its initial surface level inquiry.

If these internal procedures do not resolve the dispute, external remedies may be available. Regulation CC confers subject matter jurisdiction upon U.S. District Courts. However, courts must also have personal jurisdiction over the parties. Where the payor institution is located in a different state and does not have sufficient minimum contacts with the local state, the local court may not have personal jurisdiction. Accordingly, these circumstances may force the depository institution to bring an action in the state where the payor institution is located.

Unless the amount in controversy is great enough, filing suit out of state may not be economically feasible. Notwithstanding, even if a local court has jurisdiction over the payor institution, recoverable damages may still not be enough to justify filing suit. Additionally, such an action could prove costly, and Regulation CC does not expressly authorize for the recovery of attorney's fees.

What Can Woods Rogers Do For You? The restructuring of check-processing operations within the Federal Reserve System may result in greater exposure to fraudulent transactions for Virginia Credit Unions. Woods Rogers can help your Credit Union understand these risks and provide assistance in complying with Regulation CC and seeking cost-effective remedial measures. If your Credit Union has any questions concerning Regulation CC, please contact Nicholas Albu at (540) 983-7735.



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