

September 1991

# FINANCIAL INSTITUTIONS

## Time Limits on Holding Deposits Generally Met but More Oversight Needed



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United States  
General Accounting Office  
Washington, D.C. 20548

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General Government Division

B-244348

September 30, 1991

The Honorable Donald W. Riegle, Jr., Chairman  
The Honorable Jake Garn,  
Ranking Minority Member  
Committee on Banking, Housing  
and Urban Affairs  
United States Senate

The Honorable Henry B. Gonzalez, Chairman  
The Honorable Chalmers P. Wylie,  
Ranking Minority Member  
Committee on Banking, Finance  
and Urban Affairs  
House of Representatives

This report was prepared in response to the requirement that GAO evaluate the implementation and administration of Title VI of the Competitive Equality Banking Act of 1987, known as the Expedited Funds Availability Act. Pursuant to the act's requirement, the report discusses actions taken by the Federal Reserve Board to issue regulations implementing the act and efforts of federal financial institution regulatory agencies to establish examination procedures and monitor the act's compliance. The report also addresses check fraud loss exposure—an issue of major concern to the financial institutions' industry.

We are sending copies of this report to all members of the Banking Committees as well as to other appropriate congressional committees, federal financial institution regulatory agencies, and other interested parties. We will also make copies available to others upon request.

This report was prepared under the overall direction of Craig A. Simmons, Director, Financial Institutions and Markets Issues, who can be reached on (202) 275-8678. Other major contributors are listed in appendix IX.

Richard L. Fogel  
Assistant Comptroller General

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# Executive Summary

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## Purpose

Congress was concerned that financial institutions were placing exorbitant holds, as long as 14 days, on checks deposited into customers' accounts, making the funds unavailable to customers until the hold period elapsed. The Expedited Funds Availability Act of 1987 limited the length of time that financial institutions could hold funds from checks deposited into customer accounts.

The act requires GAO to evaluate the implementation and administration of this legislation. Accordingly, this report evaluates actions of the Federal Reserve Board (FRB) in issuing regulations implementing the act and efforts of federal regulators to monitor and enforce the act through their examination and consumer complaint programs.

Since financial institutions believe their exposure to fraud has increased as a result of the act's passage, this report also discusses check fraud losses. Financial institutions believe their exposure has been increased because, under the act's availability schedules, they now may have to make funds from deposited checks available to customers before learning whether the checks will be honored by the institution on which they are drawn.

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## Background

Title VI of the Competitive Equality Banking Act, known as the Expedited Funds Availability Act, was passed on August 10, 1987. The provisions of the act and its implementing regulation, Regulation CC, became effective on September 1, 1988. The purpose of the act was to make funds from deposited checks available to customers within specified schedules and to improve the check processing system. Under the act, a temporary availability schedule required institutions to make funds available for customers' withdrawal by the third and seventh business day following the day of deposit for local and nonlocal checks, respectively. Two years later, a permanent availability schedule was implemented; it shortened the hold period to 2 days for local checks and 5 days for nonlocal checks. The act also provided financial institutions with various exceptions to the availability schedules for, among other things, large dollar or suspicious checks; and it authorized FRB to suspend the schedules if an unacceptable level of fraud loss resulted from the act.

FRB had responsibility for implementing the act and improving the check collection and return process. The regulators responsible for administering the act include FRB, the Office of the Comptroller of the Currency,

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the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the National Credit Union Administration.

To evaluate the implementation and administration of the act, GAO reviewed the regulations, examination procedures, and examination and consumer complaint data at the headquarters offices of each of the five federal regulators. GAO also reviewed selected examination and complaint files from two regional offices of each regulator and interviewed, among others, regulators, consumer groups, and financial institutions.

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## Results in Brief

GAO found that the regulatory and administrative framework has been established through which the act can be effectively implemented. FRB has issued regulatory guidance, and a council of regulatory agency representatives has developed uniform examination procedures for monitoring compliance with the act.

On the basis of information obtained from several sources, GAO believes that financial institutions are generally complying with the funds availability provisions of the act. The most frequent violations identified in examinations and complaints usually pertained to disclosure requirements rather than lengthy delays in customers' access to their deposited funds. GAO further believes and FRB officials agree that additional clarification of those frequently violated provisions of the act may be needed to achieve greater compliance.

However, GAO found that, except for FRB, regulators in the offices visited frequently did not adequately assess financial institutions' compliance with the act. For the most part, they did not test financial institutions' check holds, as required in the uniform examination procedures, to ensure that the institutions' hold practices were actually consistent with their policies. Moreover, documentation of what examiners did to determine compliance and support their conclusions was often limited or nonexistent.

GAO also found that exposure to check fraud loss because of the act's availability schedules continues to be a major concern to the industry. Even so, for the most part, financial institutions contacted by GAO have not compiled data to substantiate their concerns about increased fraud loss exposure. In fact, the institutions contacted generally questioned whether data could be cost effectively compiled on check fraud losses directly attributable to the act's availability schedules.

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## Principal Findings

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### Framework Established to Implement the Act

FRB and the other federal regulators have established the regulatory and administrative framework to provide for the effective implementation of the act. FRB initiated the implementation of the law by issuing Regulation CC and other guidance setting forth detailed policies and procedures. Also, FRB, along with others in the financial institutions industry developed and conducted training and education programs to promote an understanding of the act. A council consisting of representatives from the five federal regulators established uniform examination guidelines for use in assessing financial institutions' compliance with the act. (See pp. 16-20.)

### Compliance With Availability Schedules Generally High but Improvements Are Needed in Examinations

On the basis of GAO's review of selected examination and complaint files, national examination and complaint data, and information obtained from consumer groups and financial institutions, GAO believes that financial institutions are generally complying with the act's funds availability schedules. The most thorough examinations—those done by FRB—did not identify exorbitant check hold practices. Instead, the most frequently violated provisions of the act usually pertained to disclosure requirements—such as notifying customers of check holds placed on deposited funds and posting availability policy notices at locations where deposits are accepted.

Less than 2 percent of all complaints filed with regulators were related to the act. According to the regulators, those complaints filed that did pertain to the act usually involved the failure of the complainant to understand the provisions of the act rather than actual violations of the act by the financial institutions.

GAO also found that while FRB examinations reviewed were thorough, those of the other regulators needed improvement to adequately assess institutions' compliance with the act. The examination files GAO reviewed showed that these regulators often did not follow the uniform examination procedures, particularly with regard to testing check holds to ensure that the institution was actually practicing its stated hold policy. Furthermore, GAO found that documentation of the procedures examiners followed in reviewing compliance with the act and in supporting their conclusions varied widely and was often limited or nonexistent.

GAO recognizes that the examination procedures developed by the council of regulators were designed for a full-scope examination and therefore are quite extensive. GAO also recognizes that the violations identified to date indicate that a full-scope examination may not always be appropriate. Therefore, GAO believes that regulators should evaluate their examination experience since the act's implementation to identify the appropriate procedures needed, including the extent of testing of check hold practices, to ensure an adequate assessment of an institution's compliance with the act. Furthermore, on the basis of the complexity of the act and the frequent violations of certain disclosure requirements reported by regulators, GAO believes that financial institutions could benefit from supplementary guidance on frequently violated provisions. (See pp. 21-36.)

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### Industry's Concern About Check Fraud Loss Has Increased but Data to Substantiate Loss Are Lacking

Implementation of the permanent availability schedules has heightened the financial institutions industry's concern about its vulnerability to check fraud loss. To help alleviate this concern, FRB has improved the check collection and return system by, among other things, streamlining the check return process. Also, in March 1990, FRB recommended several legislative amendments to facilitate compliance with the act and to reduce financial institutions' risk of check fraud loss. Despite the FRB improvements, the 33 financial institutions GAO contacted were still quite concerned about their exposure to check fraud loss. However, for the most part, these institutions have not compiled data to substantiate their concerns.

They generally do not believe it would be cost beneficial for them to collect data on fraud losses attributable to the act, because of the difficulty of isolating fraud losses occurring as a result of the act's availability schedules. Without such fraud loss data, GAO cannot determine the degree to which the industry's concerns are valid. Also, GAO did not determine the degree to which losses can be further alleviated through technological or operational improvement to institutions' check collection and return systems. (See pp. 37-44.)

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## Recommendations

To better administer the Expedited Funds Availability Act, GAO recommends the following:

- The Federal Reserve Board and the heads of the other four federal financial institution regulatory agencies should collectively evaluate their examination experience under the act and review the uniform

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examination guidelines to identify and implement appropriate examination procedures to adequately assess institutions' check hold practices. Such procedures should specify the extent of testing of check transactions needed to verify institutions' compliance with funds availability provisions and should require documentation to show support for conclusions reached.

- The Federal Reserve Board should issue supplementary guidance to highlight and illustrate the provisions of the act that institutions have most frequently violated.

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## Agency Comments

GAO obtained written comments on a draft of this report from the five federal financial institution regulators. A summary of the comments and GAO's evaluation are provided in chapter 3, and FRB's comments are also discussed in chapter 4. The regulators' written comments are included in appendixes IV through VIII.

All five of the regulators basically agreed with GAO's recommendation to work with each other to develop needed guidance. Two of the regulators, while agreeing to work with the others, expressed some concern about the need for specific uniform examination procedures for testing or documentation.

FRB expressed disappointment that GAO did not advocate its proposed legislative amendments. GAO recognizes that financial institutions are somewhat vulnerable to check fraud loss, particularly in situations like local check processing when institutions may have to make funds available to customers before they know whether the check will be honored. However, neither the proponents or opponents of the proposed amendments could provide quantifiable data, beyond anecdotal evidence, to support their views. Consequently, GAO presents for Congress' consideration the supporting and opposing perspectives of those affected by the Expedited Funds Availability Act.



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**Abbreviations**

ABA	American Bankers Association
ATMs	Automatic teller machines
EFAA	Expedited Funds Availability Act
FDIC	Federal Deposit Insurance Corporation
FFIEC	Federal Financial Institutions Examination Council
FRB	Federal Reserve Board
NCUA	National Credit Union Administration
OCC	Office of the Comptroller of the Currency
OTS	Office of Thrift Supervision

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# Introduction

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Congress enacted the Expedited Funds Availability Act (EFAA) on August 10, 1987, to respond to concerns that financial institutions<sup>1</sup> were unnecessarily delaying customers' access to the funds they deposited in their accounts. The delays resulted from the practice of some financial institutions placing longer "holds" than necessary on checks deposited to customer accounts. Financial institutions placed holds on checks because they were uncertain as to whether the payor institution would honor the check presented or return the check unpaid because of insufficient funds in the customer's account. Some institutions were placing holds on deposits ranging from 7 to 14 days. In some cases, these holds were being applied to all deposited checks, even checks that were being honored more quickly, thus giving the institution—but not the customers—use of the funds for the remainder of the hold period. As a result, customers were unnecessarily denied access to their money.

EFAA was passed by Congress largely to limit the duration of the hold that institutions could place on customers' deposited checks. Although some states had previously enacted laws concerning funds availability the laws varied widely. EFAA includes funds availability schedules that specify the allowable hold periods for various types of deposited checks such as local or nonlocal checks.

EFAA requires us to evaluate the implementation and administration of its statutory provisions. In response, we have evaluated actions taken by the Federal Reserve Board (FRB) to issue regulations implementing EFAA and efforts of regulatory agencies to establish examination procedures and monitor EFAA compliance. Additionally, this report discusses EFAA-related check fraud, a major concern of the financial institutions industry (i.e., financial institutions and trade associations). The industry believes institutions' exposure to check fraud losses has been increased because, under EFAA's availability schedules, they may have to make funds from deposited funds available to customers before learning whether checks will be honored by the institutions on which they are drawn.

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## Purpose of EFAA

Congress enacted EFAA (12 U.S.C. 4001 *et seq.*) as Title VI of the Competitive Equality Banking Act of 1987. EFAA provisions, along with FRB's implementing Regulation CC (Reg CC), became effective on September

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<sup>1</sup> Financial institutions include all commercial banks, savings banks, savings and loan associations, and credit unions with transaction accounts, such as checking accounts, that are required to comply with EFAA.

1988. The purpose of EFAA was to limit the duration of the hold time that financial institutions could place on checks deposited into customer accounts before making the funds available for withdrawal. The types of accounts affected by the law include demand deposit accounts (checking accounts); negotiable orders of withdrawal (NOW accounts); share draft accounts (typically used by credit unions); automatic transfer accounts (pre-authorized transfers); and other transaction accounts, such as payments made by telephone or through automated teller machines (ATMs).

Congress recognized that to accelerate the funds availability schedule under the existing check collection and return system could increase the risks for financial institutions in accepting for deposit "bad" checks.<sup>2</sup> Therefore, in addition to requiring prompt availability of funds, EFAA gave FRB authority to improve the check collection and return system. Authorized improvements were to be focused on shortening the time within which depository financial institutions (those in which a check is first deposited) could learn if a check was bad. If a depository institution were able to know this before it was required to make funds available to a customer, the risk of fraud loss to the institution would be reduced.

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## Provisions of EFAA and Implementing Regulation

Major provisions of EFAA require financial institutions to make funds available to customers within specified time frames, disclose their funds availability policy to customers, and begin to accrue interest on certain interest-bearing accounts. FRB issued Reg CC to implement EFAA and help financial institutions meet EFAA requirements.

As provided by EFAA and Reg CC, financial institutions were required to make customers' funds available for withdrawal in accordance with specific temporary and permanent schedules. Under the temporary availability schedules, which were in effect from September 1, 1988, to September 1, 1990, funds from local checks (those drawn on an institution within the same check processing region) were to be made available for withdrawal no later than the third business day following the day of deposit. Nonlocal checks (those drawn on an institution located in a different check processing region) were to be available for withdrawal no later than the seventh business day following the day of deposit. In addition, the first \$100 of a customer's aggregated check deposits on

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<sup>2</sup>A "bad" check is any check dishonored for insufficient funds, wrong endorsement, lack of endorsement, account closed; also called a return item.

any one banking day, whether local or nonlocal checks, was to be made available on the first business day following the day of the deposit. Finally, financial institutions were required to make the entire amount of certain types of deposits available the following business day. Deposits requiring next-day availability include cash; low-risk checks such as cashier's checks; "on us"<sup>3</sup> checks; and federal, state, and local government checks.

Except for maintaining next-day availability for cash and low-risk checks, availability schedules were generally shortened as of September 1, 1990, to enable customers to receive their funds more quickly. The permanent schedules require institutions to make funds from local checks available by the second business day following the day of deposit; funds from nonlocal checks are to be available by the fifth business day.

EFAA and Reg CC provide for certain exceptions to the specified availability schedules. If a financial institution imposes one of the exception holds, it may hold funds for a reasonable period. Under the permanent schedule, it is considered reasonable to hold funds for 5 business days longer than the times set by the schedules for local checks and for 6 business days longer for nonlocal checks, thereby permitting exception holds<sup>4</sup> of 7 and 11 business days for certain local and nonlocal checks, respectively. These exception holds are provided for transactions like those involving new or problem customer accounts or large deposits of checks that are for amounts over \$5,000 or regarded as suspicious.

EFAA also requires each financial institution to

- provide a disclosure of its policy on when customers may withdraw deposited funds;
- post a notice summarizing its policy in branch lobbies, post or provide notice at owned or operated ATMs;
- include a notice on preprinted deposit slips; and
- give a notice when it imposes an exception hold that delays the availability of funds.

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<sup>3</sup>An "on us" check is payable from funds on deposit at the same bank where it is presented for collection.

<sup>4</sup>Provisions by which financial institutions may protect themselves from risk of loss when providing prompt funds availability.

Also, EFAA requires institutions to pay interest on funds deposited into customers' interest-bearing accounts no later than the business day on which the institution receives or expects to receive credit for the deposited check from the payor institution. This provision was intended to address the complaint that institutions get free use of funds from deposited checks before they permit their customers to have access to them.

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## Objectives, Scope, and Methodology

The statutorily mandated objectives of our study were to determine whether EFAA has been (1) effectively implemented by the FRB and affected financial institutions, and (2) effectively administered by the five regulatory agencies that are responsible for assessing institutions' compliance with EFAA provisions. The regulatory agencies include FRB, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA). We also reviewed the issue of check fraud as it relates to EFAA.

To verify the effectiveness of EFAA's implementation and administration, we compared for consistency the EFAA provisions, Reg CC provisions, and Federal Financial Institutions Examination Council (FFIEC) guidelines.<sup>5</sup> We also selected for review a random sample of 100 compliance examination files—10 files from each of the 5 regulators in their New York and San Francisco regional or district offices. We selected these regions, in part, because they included financial institutions with large numbers and amounts of depository accounts. Since some of our randomly chosen examination files were either not readily available or predated the regulator's implementation of its examination guidance for Reg CC, we replaced the selected files randomly from the remaining available compliance examinations.

The random sample included examinations completed since EFAA became effective on September 1, 1988. We reviewed 97 of the 100 sampled examinations. Because NCUA's examination files were difficult to locate and those reviewed contained such limited information relative to Reg CC, we discontinued our review of these compliance examinations, resulting in three fewer NCUA files reviewed than we initially planned. We assessed the 97 examinations for their adequacy on the basis of evidence in the examination files that described examination procedures

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<sup>5</sup>The FFIEC Task Force on Consumer Compliance, which comprises representatives from the five federal financial institutions regulators, developed examination procedures for use by the regulatory agencies during their examination of a financial institution's compliance with EFAA. The examination procedures were adopted on August 15, 1988.

actually used, including any testing of institutions' check holds, and provided the basis for the conclusions reached by examiners about the institutions' compliance with EFAA. Where the examination file documentation was lacking, we discussed the case with officials knowledgeable about the examination procedures used in the specific case or by that office. We considered their comments in our analysis of the adequacy of examinations. We also reviewed consumer complaint files maintained by regulators in the two geographic areas to determine which EFAA provisions had been the subject of complaints and to identify the regulators' actions taken to resolve them.

We also sought the five financial institution regulators' national statistics on their compliance examinations to determine, among other things, the most frequently violated EFAA provisions for comparison to those violations identified in the examination and compliance files we reviewed in New York and San Francisco. However, OTS and NCUA were unable to provide us with national statistics on thrift and credit union examinations, respectively. We did not independently verify the examination and complaint statistics we obtained from the three bank regulators.

We interviewed federal regulators in the Washington headquarters and two field offices as well as representatives from federal and state regulatory agencies, trade associations, and financial institutions in both geographic areas to get their views on EFAA's implementation and administration. The interviews included the regulatory officials responsible for Reg CC compliance examinations for banks (FRB, FDIC, OCC), thrifts (OTS), and credit unions (NCUA). We met with Washington, D.C., and regional or district representatives from the consumer advocate group and industry associations who had strong interests in the formulation of the law and regulation. We also contacted financial institutions whose financial reports reflected the largest dollar volumes of deposits and those whose officials were willing to volunteer information about their check processing and return systems and their implementation of EFAA, particularly with regard to any concerns they had about check fraud losses attributable to EFAA.

To further increase our understanding of financial institutions' exposure to check fraud loss, we visited and observed check clearing and return operations at the Chicago and New York clearinghouses,<sup>6</sup> in addition to

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<sup>6</sup>Clearinghouses are usually voluntarily formed by financial institutions to exchange checks, drafts, or other forms of indebtedness held by one member and owed to another.

the Baltimore branch of the Federal Reserve Bank of Richmond. To better understand and address the issue concerning the nonproprietary ATM amendment,<sup>7</sup> we met with officials of Money Access Service (Philadelphia) and Cash Station, Inc. (Chicago) to discuss and observe ATM deposit processing procedures and how EFAA affected their operations. These two organizations are among the largest of the ATM networks.

From interviews with representatives of the regulatory agencies, financial trade associations, professional services organizations, and consumer advocate groups, we obtained information about EFAA changes to the check clearing and return process. We also reviewed proposed EFAA amendments to understand how they could facilitate administration of the law and alleviate the potential for check fraud loss. Further, we attempted to obtain information from those interviewed on the type of check fraud loss data needed to identify risks or losses attributable to EFAA. The organizations we contacted are listed in appendix I.

We did our work from April 1990 through March 1991 in accordance with generally accepted government auditing standards.

We obtained written comments on a draft of this report from the five federal financial institution regulators. A summary of the comments and GAO's evaluation are provided in chapter 3, and FRB's written comments are also discussed in chapter 4. The regulators' written comments are included in appendixes IV through VIII.

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<sup>7</sup>This was an amendment proposed by the FRB to allow financial institutions to treat deposits made by their customers at another institution's ATMs as nonlocal checks.

# Framework Has Been Established to Provide for EFAA's Effective Implementation

FRB and financial institution regulators have established the regulatory and administrative framework needed to effectively implement EFAA. FRB implemented the law by issuing Reg CC and detailed policies and procedures. FRB and various financial trade associations developed and conducted training and education programs to help financial institutions understand their responsibilities under EFAA. Additionally, the Federal Financial Institution Examinations Council (FFIEC) developed and distributed uniform examination guidelines that the five federal financial institution regulators have adopted—in varying forms—in their examination requirements for assessing financial institutions' compliance with EFAA.

## Issuance of Reg CC

Consistent with EFAA provisions, Reg CC, entitled Availability of Funds and Collection of Checks, became effective on September 1, 1988. Before publishing the final regulation in May 1988, FRB issued for public comment a proposed Reg CC on December 11, 1987. More than 1,000 comments were received on the proposed regulation, many of which FRB described as being very thorough and providing excellent analyses of issues raised. According to FRB, some comments stated that the proposal did a good job of implementing EFAA's requirements and provided guidance that was essential for industry compliance. However, many commenters expressed concern over EFAA's and Reg CC's complexity along with the increased costs and risks to the financial institutions industry due to the disclosure and funds availability requirements. Specifically many commenters were concerned with the risks to financial institutions inherent in the requirement that they provide next-day availability for certain check deposits, such as government and teller's checks.<sup>1</sup> They believed that expansion of exception holds to these types of checks would reduce institutions' exposure to risk from loss of funds due to check fraud because they would have more time to be certain the check would be honored by the institutions on which the checks were drawn.

FRB staff considered the comments received and held discussions with representatives of consumer and industry groups concerning the proposed regulation. In addition, two consulting firms assessed the effect the proposed rule on the financial institutions industry. On the basis of its analysis of all of this information, FRB adopted the final regulation in May 1988.

<sup>1</sup> A teller's check is a check drawn by a financial institution on another financial institution or pay through or at such an institution.

Reg CC contains three subparts. Subpart A defines terms and provides for administrative enforcement. Generally, the terms in the regulation are defined as they are in EFAA. Subpart B, the core provisions that specify periods within which financial institutions must make funds available for withdrawal, reflects the availability schedules in EFAA. For example, deposits of cash and electronic payments, as well as certain check deposits, must be made available for withdrawal on the next business day following deposit. Longer availability schedules apply to other check deposits on the basis of whether the checks are local or nonlocal as described in chapter 1.

Subpart B also includes rules regarding disclosure of funds availability policies, exceptions to the schedules, and payment of interest. This section requires a financial institution to disclose, to any individual opening a new account and to anyone upon request, the institution's policy regarding when funds deposited to a customer's account will be available for withdrawal to that customer. Also, Subpart B requires financial institutions to disclose their availability policies in localities where customer deposits are accepted by financial institution employees and to provide notices at ATMs and on preprinted deposit slips that deposited funds may not be available for immediate withdrawal. Finally, Subpart B reinforces the provisions of the law relating to extended holds and payment of interest on deposits; these two provisions of the law were also discussed in chapter 1.

Subpart C of Reg CC contains rules intended to speed the collection and return of checks that FRB developed under its EFAA authority to improve the check clearing and return process. These rules cover the responsibilities of financial institutions to return dishonored checks expeditiously along with their authority to return checks directly to the depository institution rather than routing them through all those who endorsed the checks. The rules also include the specific requirements for the notification of nonpayment of large-dollar returns by the paying financial institutions, as well as newly established check endorsement standards and other changes related to the check collection system.

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## **Training and Education on EFAA Requirements**

On the basis of interviews with FRB and various trade association officials and our examination of training materials they developed, we believe that these organizations have made a concerted effort to train financial institution staffs on the implementation of Reg CC provisions. These training efforts should help institutions comply with EFAA.

FRB, the American Bankers Association (ABA), Consumer Bankers Associations, Independent Bankers Association of America, Credit Union National Association, and the United States League of Savings Institutions conducted various programs to educate bankers and other personnel in financial institutions about how to comply with Reg CC. During the public comment period prior to final issuance of Reg CC, FRB held over 220 educational seminars throughout the country to explain the proposed regulation. According to an FRB report, approximately 17,500 participants attended these seminars, representing over 9,000 financial institutions.

After adoption of the final regulation, FRB continued its educational efforts by, among other things, establishing a telephone "hotline" program to answer questions on Reg CC. Additional FRB seminars provide participants with a slide show that summarized Reg CC compliance issues and samples of disclosure forms and consumer brochures to help both officials of financial institutions and customers understand the new regulatory requirements. According to an FRB report, about 300 of these seminars were held with over 37,000 people attending, representing over 16,000 financial institutions. FRB information explained what financial institutions should do to comply with EFAA and Reg CC. FRB reported that in 1988, it spent over \$2.1 million to provide educational assistance in implementing EFAA and Reg CC.

ABA hosted a symposium to assist bankers in reviewing and composing comments on the proposed regulation. After the final regulation was adopted, ABA as well as other trade organizations assisted in providing various types of training activities to promote the understanding and implementation of Reg CC. The organizations used the following means to train financial industry participants: educational seminars, national compliance teleconferences, training videos and compliance manuals, and newsletter publications. We reviewed educational and training materials, including those used by FRB in its seminars, and found the materials to be quite detailed and descriptive in explaining the responsibilities of financial institutions in meeting the requirements of EFAA and Reg CC.

Financial institutions we contacted during this review indicated they had to allocate extra time and money for training their staffs. For example, an official at one institution said it had allocated about \$1.3 million to provide employees training on their responsibilities and provide customers with disclosures about the institution's hold policies to meet EFAA requirements. An official at another institution said tellers

were given a 1-hour training session in which they were provided with a packet that explained EFAA and their responsibilities under it. Following the training session, tellers had to sign a statement acknowledging that they understood their EFAA responsibilities.

Regulators told us that their examiners received EFAA and Reg CC training as part of their respective compliance courses. Regulators also incorporated into their compliance examination manuals additional guidance on examiners' responsibilities and requirements for ensuring EFAA compliance by regulated institutions. Our review of the training materials and examination guidelines showed that they were generally consistent with EFAA and Reg CC provisions.

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## **Uniform Guidelines** **Established to Monitor** **Compliance**

Under the provisions of EFAA, FRB, OCC, FDIC, OTS, and NCUA are charged with responsibilities to enforce EFAA; therefore, each regulator must exercise sufficient oversight to ensure compliance by the financial institutions it supervises. Enforcement of Reg CC is accomplished primarily through regulators' compliance examinations. On August 15, 1988, FFIEC adopted procedures and checklists for examining compliance with Reg CC provisions. We believe that these examination procedures, if effectively used, provide adequate guidance for regulators to assess compliance with essential provisions of the law and regulation.

FFIEC was established by Congress in 1979 to serve as a formal inter-agency body with authority to prescribe uniform principles, standards, and report forms for federal examination of financial institutions. Among other things, a primary function of FFIEC is to promote consistency in federal examinations. In line with this objective, an FFIEC subcommittee on examination procedures, comprised of representatives from all five regulators, developed uniform examination procedures for use by regulators to assess compliance with Reg CC. In line with their discretionary authority in adopting the FFIEC guidance, all of the regulators have incorporated into their compliance manuals the FFIEC examination procedures or some modification thereof. In chapter 3, we discuss the specific examination procedures actually used by each regulator. We also assessed their adequacy for supporting the conclusions reached by examiners about institutions' compliance with EFAA.

The FFIEC examination guidelines for enforcing Reg CC requirements are based upon four objectives and include specific procedures and a checklist of questions to assess Reg CC compliance.

The examination objectives require that examiners determine that the financial institution

(1) has established funds availability policies that are in compliance with Reg CC,

(2) has established internal controls for ensuring compliance with Reg CC,

(3) has established a training program for applicable employees concerning their duties with respect to the regulation, and

(4) maintains records of compliance with Reg CC for a period of 2 years.

FFIEC examination procedures cover the full scope of Reg CC and are quite extensive. The FFIEC checklist also should help ensure that examiners cover the major provisions of Reg CC in the course of their examinations. Through questions that generally parallel examination procedures, the checklist covers specific financial institutions' policies and procedures on calculating hold periods, special rules for ATMs, extension holds, payment of interest, and other matters. Appendix II contains the FFIEC examination checklist.

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## Conclusions

The combined efforts of FRB and other federal regulatory agencies have provided a framework through which EFAA can be effectively implemented. Regulatory guidance was provided in detail through FRB's issuance of Reg CC and other supporting guidance and FFIEC's development and distribution of uniform examination guidelines. Also, due to the efforts of FRB and the trade associations, education programs have provided considerable training on principal EFAA and Reg CC provisions help regulators and financial institutions comply with their responsibilities.

# Compliance With Availability Schedules Is Generally High, but Improvements Are Needed in Examinations

On the basis of our review of selected examination and complaint files, national examination and complaint data, and information obtained from consumer groups and financial institutions, we believe that financial institutions are generally complying with the funds availability provisions of Reg CC. Identified violations that have been reported, for the most part, do not relate to EFAA provisions involving excessive check holds on customers' deposits. Instead, they pertain to such issues as the financial institution's failure to meet disclosure requirements by not notifying customers of certain check holds or not properly posting availability policies at designated locations. The few violations of funds availability provisions that have been identified through regulators' compliance examinations have not resulted in formal enforcement actions.

Regulators' experiences with Reg CC compliance examinations over the last couple of years tend to demonstrate that exorbitant check holds are no longer being placed on deposited funds. However, from our limited review of examination files in two geographic locations, we found that only the FRB examinations consistently provided a thorough assessment of institutions' compliance with EFAA, including evidence of testing of check holds to ensure that the institutions' practices were consistent with their policies. The FRB examinations basically followed the uniform guidelines developed by FFIEC, while the other regulators varied in the extent to which they used the FFIEC guidance. Moreover, documentation of what examiners did to determine compliance was often limited or nonexistent. Consequently, examination procedures used by these regulators have not provided a consistent or reliable approach for measuring Reg CC compliance. We believe that regulators need to improve their EFAA administration through the consistent application of examination procedures that include requirements for testing check holds to ensure that institutions' practices are consistent with their stated policies.

## Reported Violations of Reg CC Have Not Resulted in Formal Enforcement Action

Our review of national statistics from the bank regulators (FDIC, FRB, and OCC)<sup>1</sup> indicated that violations of Reg CC are frequently identified and reported to bank management. However, regulators have not considered the violations found serious enough to warrant formal enforcement action—such as cease and desist orders—because the violations, for the most part, involved failures to disclose bank hold policies rather than more serious violations, such as failure to adhere to the funds availability schedules.

<sup>1</sup>OTS and NCUA were not able to provide nationwide statistics on Reg CC violations.

**Wide Disparity Among  
 Bank Regulators in  
 Reported Violations**

The data from the bank regulators showed a wide variation in the frequency with which they cited institutions for violations of Reg CC (see table 3.1). While FRB reported violations of Reg CC in over 60 percent of its compliance examinations, FDIC reported violations in only about 14 percent.

**Table 3.1: Examinations With Reg CC  
 Violations by Regulator (9/1/88 to 6/30/  
 90<sup>a</sup>)**

Regulator	Exams	Exams with Reg CC violations	Percent
FDIC	5,396	765	
FRB	911	569	
OCC	1,273	355	

<sup>a</sup>FRB data covers the time period January 1, 1989, through June 30, 1990, because examination data for 1988 was not available.

FRB examinations show the highest percentage of Reg CC violations, which we believe could be attributable to the fact that FRB examination procedures followed the uniform guidelines developed by FFIEC. Regulators, including FRB, report that institutions are generally providing customers with timely access to their deposited funds as required by Reg CC, but some may not be fully complying with other Reg CC provisions such as disclosing funds availability information or notifying customers of check holds placed on deposited funds.

**Few Reported Violations  
 Involved the Funds  
 Availability Provisions**

We further analyzed the national statistics to determine the type and frequency of Reg CC violations cited during examinations by the three bank regulators. Our review generally supported what we had been told by regulatory officials: the more common violations did not involve the EFAA provisions requiring banks to make funds available for withdrawal within specific periods.

Examinations by the three bank regulators, as reflected in national statistics, seldom resulted in cited violations of the funds availability provisions of Reg CC. The examination statistics show that violations of individual Reg CC provisions were cited more frequently by FRB than the other bank regulators. Still, FRB cited the failure to comply with local and nonlocal availability schedules in only about 8 and 5 percent of its examinations, respectively. For checks requiring next-day availability, the most common violation cited in FRB examinations involved state and local government checks. FRB cited violations of this provision in about 10 percent of its examinations. Violation data reported by FDIC and OCC also showed few violations of funds availability provisions.

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## **Informal Enforcement Actions Have Been Taken**

Reg CC violations that were identified were typically addressed through informal actions, such as discussions with management or memoranda of understanding in which cited banks agreed to take corrective action. FRB officials we spoke to in both headquarters and the two district offices said FRB has not initiated formal enforcement action against a bank solely on the basis of Reg CC violations. According to these officials, the violations found have generally not been serious enough to warrant such action. In our discussions with officials of the other bank regulators, as well as those of OTS and NCUA, we learned that the Reg CC violations found were generally considered not significant and could be addressed through informal actions.

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## **Examination Results Show Common Violations**

The violations regulators identified most frequently in the examination we reviewed were consistent with those reported to Congress by FRB in its 1990 report<sup>2</sup> on EFAA. The types of violations cited most frequently were also consistent among the bank regulators (see appendix III). Some of the more common violations found during bank examinations include failure to

- provide a written notice when an exception hold is placed on a deposit;
- meet the additional disclosure requirements, such as posting the financial institution's availability policy at locations where employees accept deposits; and
- meet the specific availability policy disclosure requirements for case-by-case holds.

Another frequently cited violation involved institutions' failure to establish procedures and provide adequate training for employees to ensure compliance with the regulation. While regulators cited this as a separate violation, it was generally identified in conjunction with other violation and was viewed by some regulators as the cause for those violations.

Only one frequently cited violation concerned the funds availability provisions—failure to provide customers availability of the first \$100 of their daily aggregate deposits of checks on the next business day (except for those deposited checks already requiring next-day availability). While this violation involves only the first \$100 of the aggregate deposits, it can result in customers not having use of a portion of their deposited funds as required by Reg CC.

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<sup>2</sup>The 1990 Report to Congress Under the Expedited Funds Availability Act, Board of Governors of the Federal Reserve System, March 1990.

We discussed these frequently cited violations, particularly the violation involving the first \$100, with the FRB officials responsible for EFAA implementation. They agreed that additional clarification may be needed to assist financial institutions in understanding and complying with the more complex provisions of Reg CC.

## Few Consumer Complaints Have Been Reported and Generally Did Not Involve Violations of Reg CC

National statistics on consumer complaints from each of the regulators show that Reg CC complaints—those relating to funds availability—accounted for only a small fraction of all consumer complaints received. The regulators' resolution of these Reg CC complaints generally did not result in the financial institution being cited for a violation of the regulation. The data in table 3.2 show that Reg CC related complaints accounted for 2 percent or less of all consumer complaints reported by each regulator.

**Table 3.2: Percentage of Consumer Complaints Reported by Regulator Pertaining to Reg CC Violations (9/1/88 to 6/30/90<sup>a</sup>)**

Regulator	Complaints received <sup>b</sup>	Reg CC related	Percent	Reg CC complaints with no violation <sup>c</sup>
FDIC	4,995	59	1.2%	7
FRB	2,144	42	2.0	7
NCUA	1,734	16	0.9	1
OCC	20,677	207	1.0	6
OTS	22,997	338	1.5	6

<sup>a</sup>FDIC and FRB data are for 1/1/88 to 6/30/90, and may include complaints about funds availability made prior to the 9/1/88 effective date of Reg CC.

<sup>b</sup>The number of complaints reported for each regulator varies widely for several reasons. These include the number of consumers who hold accounts with institutions that fall under a given regulator's purview and whether the consumer complaint data captured by the regulator include telephone complaints or inquiries or just written complaints.

<sup>c</sup>This does not include complaints that were not resolved at the time that we received the complaint data from the regulators, nor those for which no resolution data was provided.

<sup>d</sup>NCUA could not provide data on how complaints were resolved.

We also reviewed the consumer complaint files at the regulators' field offices we visited. Through discussions with officials, we learned that complaints often resulted from a lack of understanding on the part of the consumer, rather than actual violations of Reg CC. The number of complaints we reviewed in the regulators' two regional offices varied; nevertheless, complaints were generally resolved by the regulator simply providing the consumer with a clarification of Reg CC or by

acting as an intermediary to establish the facts of a particular complaint. When the regulator acted as an intermediary, the financial institution involved was usually found to be in compliance with Reg CC, and the consumer was provided with an explanation of the financial institution's funds availability policy.

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**Consumer Groups Indicate  
That Funds Availability  
Complaints Have  
Decreased**

In its March 1990 report to Congress on EFAA, FRB stated that consumer groups were "generally pleased" with the effect of EFAA. Representatives of the consumer groups we spoke with were those who were most actively involved in EFAA's formulation. They told us that they have received few consumer complaints concerning funds availability in recent years, and financial institutions seem to be complying with the funds availability provisions of Reg CC.

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**FFIEC Provided  
Adequate  
Examination  
Guidelines to Assess  
Compliance, but  
Regulators Have Not  
Uniformly Applied  
Them**

The examination guidelines developed by FFIEC provide extensive procedures and a lengthy checklist that permit examiners to assess an institution's compliance with virtually all aspects of Subpart B. To assess institutions' funds availability procedures, FFIEC examination procedure require, among other things, that the examiner test various holds placed on deposits. Testing ensures that the examiner reviews the actual holds being placed on deposits to determine whether the institution is in compliance with both the funds availability provisions of Subpart B and the stated policy of the financial institution.

Regulators have generally incorporated FFIEC's examination procedures into the guidance they provide to their examiners. However, we found some variation in how they were incorporated and great variation in how regulators applied the procedures. In discussions with regulatory officials, we learned that given the large number of consumer laws to be reviewed, resource and time constraints do not always permit examiners to follow the FFIEC guidelines. Officials at one agency said that their philosophy is to minimize the amount of testing done by examiners; consequently, their examiners focus on institutions' policies and control systems and generally test transactions only when problems appear likely. We discussed the lack of conformity to FFIEC examination procedures with an FFIEC official who said that

the procedures serve as a uniform guide, but regulators are not required to adhere to them. Indeed, the instructor's manual for Reg CC examinations, which was developed by FFIEC, states: "Modification of the examination procedures is left to the discretion of each individual agency and the scope of the examination."

While each regulator has the discretion to modify the FFIEC guidelines, we believe a thorough assessment of an institution's check hold policies as well as its practices is essential for ensuring compliance with EFAA's intent. We believe testing requirements like those included in the FFIEC guidelines are needed for determining that an institution's stated policies and practices agree. Such testing, in our view, should be omitted only under certain circumstances. For example, in rare instances, where internal auditors have recently tested a financial institution's check hold practices, it may be feasible for the federal examiners to rely on such testing provided they review and test the auditors' work for adequacy. Under normal circumstances, however, we would expect compliance examiners to independently test check hold practices of financial institutions.

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## **Use of Examination Procedures Varies**

FFIEC guidance developed for Reg CC examinations is comprehensive in that it includes the Reg CC availability requirements along with specific examination procedures and a checklist covering major provisions of the regulation. Use of the examination procedures and/or the checklist is intended to help examiners to adequately assess financial institutions' compliance with Reg CC. The scope of the compliance examination and the extent to which examiners must use the examination procedures are left to the individual regulator.

Our review of the guidance provided to examiners indicated that regulators vary in their application of the procedures established by FFIEC. Only FRB requires examiners to complete the FFIEC checklist for each institution examined. The approach of FDIC, OCC, and OTS in applying the FFIEC guidance is to recommend that examiners follow the steps specified in FFIEC's examination procedures or complete its checklist of questions. Officials from these regulatory agencies said that examiners are responsible for assessing institutions' compliance with numerous consumer protection laws, including EFAA, and have limited time and resources to complete their examinations. Therefore, they focus their examinations on institutions' policies and control systems for ensuring compliance with the various laws—with testing of transactions generally done only when problems are evident. NCUA, on the other hand, use

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the checklist only on an exception basis. NCUA officials believed that this procedure was sufficient considering that their examination resources are limited and credit unions generally provide next-day availability.

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## **Examination of Case Files Yields Mixed Results on Adequacy of Procedures**

On the basis of our review of sampled examination cases, we found the procedures employed by examiners and documentation maintained in examination files in the field offices we visited ranged from quite sufficient to completely inadequate. Examiners in the two FRB field offices generally adhered to FFIEC guidelines through which they adequately assessed institutions' EFAA compliance. On the other hand, examination files we reviewed from other agencies often failed to demonstrate that examiners followed procedures which adequately assessed the financial institutions' compliance with Reg CC. As a result, we believe that most regulators need to make substantial improvements in their Reg CC compliance examinations by assessing institutions' practices as well as their policies and better documenting the basis for their conclusions.

To determine whether the actual examination procedures followed by examiners and documentation maintained in examination files were adequate to ensure compliance with Subpart B of Reg CC, we visited two district or regional offices of each regulator to review examination files and discuss examination procedures with field officials. Generally, we judged an examination to be adequate if the examination file demonstrated procedures were followed that could reasonably be expected to determine whether the examined institution was in compliance with Subpart B. Our assessment was not based on whether the FFIEC examination guidelines were followed, but rather on whether the procedures used demonstrated an adequate assessment of Reg CC compliance.

We considered the documentation of procedures followed to support the examiner's conclusion to be important in our assessment of the examination files because such documentation permits supervisory review and indicates due professional care. Where the examination file documentation was lacking, we discussed the case with officials knowledgeable about the examination procedures used in the specific case or by that office. We considered their comments in our analysis of the adequacy of examinations.

We selected 100 examination files to review, 10 files from 2 field offices for each of the 5 regulators. However, due to the limited information contained in NCUA files, we reviewed only 7 files at 1 of its field offices

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and therefore reviewed 97 examination files overall. The files were randomly selected at each office from all examinations that were done between September 1, 1988, and June 30, 1990, except for NCUA. We randomly selected NCUA cases completed after October 1, 1989, since NCUA first included examination procedures for Reg CC compliance in its examiner's guide in October 1989. NCUA officials said files for examinations begun prior to that time would rarely contain any documents relating to Reg CC.

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**FRB Examination Files  
Reflected Adequate  
Assessment of EFAA  
Compliance**

Files we reviewed at the two Federal Reserve district offices routinely contained documentation of the examination procedures followed and demonstrated adequate support for the conclusions drawn by the examiners. Of the 20 files reviewed, 19 contained a completed FFIEC checklist. From the documentation in 17 of those files, we could determine that the conclusions reached by the examiners were adequately supported. All 17 files included the completed checklist and evidence that holds placed had been tested to ensure that the institution's procedures complied with EFAA and Reg CC requirements. Our discussions with district officials confirmed that examiners in both districts were required to complete the checklist and test holds placed on deposits.

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**OCC Examination Files  
Varied in the Adequacy of  
Reg CC Compliance  
Assessments**

Our analysis of the 20 examination files from the OCC field offices showed somewhat mixed results. OCC's examination procedures for Reg CC are taken directly from the FFIEC examination guidance and include steps that require testing. The procedures have been included in OCC's examination manual to be used by examiners in assessing Reg CC compliance. Examiners from the two district offices we visited differed in the extent to which they applied these examination requirements.

At one office, we found that examiners generally followed the OCC examination procedures, including the steps that require testing; however, at the other office, examiners exercised more discretion in complying with the examination guidance. This difference in approach was reflected in the adequacy of the examinations we reviewed at these two offices. That is, examination files from the office that required OCC procedures to be followed provided better support for the conclusions reached than did files from the other office.

At the office that generally met the requirements of OCC examination procedures, 8 of the 10 examination files we reviewed contained an annotated copy of OCC procedures documenting what the examiner had

done, and the documentation included evidence of testing. We were, however, concerned about the adequacy of the testing in one of the eight files, given that the only evidence of testing was a notation in the file that holds were reviewed. The remaining two examination files, which were done during the months immediately following implementation of Reg CC, contained a copy of outdated procedures that OCC used prior to Reg CC,<sup>3</sup> and had no evidence of testing. In all, we determined that 7 of the 10 files reviewed at this district office included adequate information about the banks' hold policies and documentation of adherence to those policies to support the examiners' conclusions.

At the district office in which examiners exercised more discretion, we found a copy of the OCC examination procedures in 7 of the 10 examination files reviewed. However, the copies were often not annotated sufficiently to determine what the examiner had done. Furthermore, we found no evidence of testing in six of the examination files, and some files contained only the institution's EFAA disclosure policy. Only 2 of the 10 examination files reviewed at this district had adequately supported the examiners' conclusions.

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**Lack of Documentation at  
FDIC Made Determination  
of EFAA Compliance  
Difficult**

Only 2 of the 20 examination files we reviewed at the 2 FDIC regional offices contained the FFIEC checklist, and only 1 examination adequately supported the examiner's conclusions. While FDIC examiners are not required to complete the checklist, we believe adequate documentation is essential to support examiners' conclusions. In addition, we believe the overall lack of documentation makes supervisory review virtually impossible.

Follow-up discussions with six field offices<sup>4</sup> in one FDIC region raised further questions concerning the adequacy and consistency of FDIC examinations. We were told by officials at three field offices that they do not test holds placed on deposits; officials from the other three offices said that they do. An official at one field office told us that testing is considered an important part of the examination because it assures the actual practices of the institution are reviewed. We found

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<sup>3</sup>OCC reviewed the funds availability policies of banks as part of its normal compliance examination prior to Reg CC taking effect. The procedures used were superseded by the much more extensive procedures derived from those developed by the FFIEC.

<sup>4</sup>EFAA compliance reviews are handled by FDIC regional offices which are further supported by field offices.

that 30 of the 33 violations cited in the 10 exam files we reviewed in this region were identified by the field office that advocated testing.

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### **Documentation and Testing Found Generally Lacking in OTS Examinations**

From our review of 20 examination case files, we found variation in how the two OTS district offices applied the examination procedures. OTS' regulatory handbook characterizes the use of checklists as supplemental and states that although checklists are not required, examiners should complete them. At 1 office we found the completed checklist in all 10 of the examination files we reviewed. However, we found that only four were adequately documented to support the conclusions examiners reached about Reg CC compliance. In follow-up discussions, OTS officials told us that documentation was generally required only where exceptions were found. We were also told that testing of holds was time consuming and was sometimes not done if the examiner was reasonably confident of compliance.

At the second OTS district office we found that only 4 of the 10 examination files we reviewed contained the checklist. Furthermore, most files had no evidence of testing, and only five contained the thrifts' EFAA disclosure policy. We therefore believe that all of the examination files we reviewed at this office were inadequately documented to support the conclusions reached. After discussing our findings with district officials they told us that OTS' reorganization of its consumer compliance office in June 1990 had resulted in more thorough examinations and better documentation. Therefore, we reviewed five files from examinations completed between June and August 1990. Although we found these files to be better organized and documented, they contained no evidence that examiners had tested holds.

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### **Abbreviated Examination Approach at NCUA Was Inadequate for Assessing Compliance**

NCUA did not include examination procedures for Reg CC in its examiner's guidance until October 1989, over a year after Reg CC became effective. The procedures they adopted were unlike those of other regulators. They generally required only that the examiner respond to the following four broad questions:

(1) Has the credit union determined the applicability of the specific subparts of the regulation to its credit union?

(2) If applicable, has the credit union established written funds availability policies that are within the standards of Subpart B of the regulation for local and nonlocal checks received as deposits in transaction accounts?

(3) Is credit union management knowledgeable about general and specific disclosure requirements of the Regulation?

(4) Does the credit union adhere to the endorsement standards required in Subpart C of the Regulation?

A negative response to any one of these questions would require the examiner to complete the FFIEC checklist for Reg CC.

This approach raises serious concerns because the four questions do not achieve the examination objectives set forth by FFIEC. NCUA's question 2 comes closest to achieving one of the FFIEC examination objectives in that it asks the examiner to determine whether the credit union's funds availability policies comply with Reg CC (the first of the FFIEC objectives). However, NCUA chose to limit the hold policies reviewed to those for local and nonlocal checks, while the FFIEC objective is to determine that all of the institution's funds availability policies comply with Reg CC.

NCUA's questions do not provide a basis to determine the adequacy of the credit union's procedures, internal controls, and training for compliance with Subpart B of Reg CC. Without evidence beyond the responses given to these four questions, neither we nor NCUA supervisory personnel can assess the adequacy of NCUA compliance examinations.

All 17 of the examination files we reviewed at NCUA regional offices contained the 4 questions and the examiner's response. None of the examiners gave a negative response to any of the questions; therefore, NCUA guidance did not require completed FFIEC checklists for any of the examinations. We asked the director of one NCUA regional office if we could review a file in which the FFIEC checklist was used. We were told that it would be difficult to locate a file containing the checklist because it is so rarely used. He also said that NCUA does not maintain records on whether the FFIEC checklist was used or on whether Reg CC violations were cited.

Although all 17 files we reviewed at NCUA contained the 4 questions required by the regulator, none of the files contained documentation for

the responses given or any indication that testing had occurred. On the basis of follow-up discussions with regional officials, we were unable to determine whether procedures followed were adequate to support the conclusions reached in any of the examinations we reviewed.

NCUA officials at one regional office did not believe the work done by their examiners was inadequate. They stressed the point that they know their institutions and do not believe any increase in examination or testing is warranted. Furthermore, the officials noted that limited agency resources would affect any decision to change examination procedures.

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## **Cited Violations and Examination Adequacy May Be Related**

From our review of national statistics on EFAA violations and examination procedures for the different regulators, we believe that the stringency of the examination procedures is related to the frequency with which regulators cited violations of Reg CC. For example, FRB, which cited Reg CC violations far more frequently than other bank regulators, was the only regulator where examiners routinely completed the FFIEC checklist for institutions examined. In addition, from our review of the sampled examination files, FRB was the only regulator to have adequately documented examination procedures. FDIC, which we found to have used adequate procedures in only 1 of the 20 examination files reviewed, was the least likely of the 3 bank regulators to cite violations of Reg CC.<sup>5</sup> Even at FDIC, however, 30 of 33 violations cited by regulator in 1 region we visited were found in the 1 office that advocated testing.

Although we believe that there is an association between the number of cited violations and the stringency of examination procedures, our sampling methodology was not designed to determine the strength of this association.

A further indication of how the examination procedures used may have affected the assessment of an institution's compliance was found when we reviewed the national statistics on the types of violations that the bank regulators cited. FDIC examiners cited banks for failure to meet the additional disclosure provisions of Subpart B nearly twice as often as any other provision. To identify a violation of this type an examiner may only need to look in the bank lobby or at an ATM machine to see whether a notice of funds availability was posted or disclosed. By contrast, the violations cited most frequently by FRB examiners generally

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<sup>5</sup>National statistics on EFAA violations were available only from the three bank regulators.

could be found only through a review of the practices followed by the banks examined.

The probable relationship between the adequacy of examination procedures and the frequency of examinations with Reg CC violations demonstrates the need for adequate procedures to assess EFAA compliance.

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## **Conclusions**

On the basis of our review of sampled examination files—particularly the thorough examinations done by FRB—coupled with the national statistics on Reg CC violations, and the Reg CC-related consumer complaints filed with regulators and consumer groups, we believe that financial institutions are generally in compliance with the funds availability provisions of EFAA.

Some EFAA provisions (such as disclosure of funds availability information and the requirement that written notices be provided when holds are invoked) have been frequently violated, but these violations have generally not involved institutions placing extensive holds on deposited funds. These repeated violations, coupled with commenters' concern about EFAA's complexity (mentioned in ch. 2), tend to indicate that financial institutions need some additional guidance on what constitutes compliance with these frequently violated provisions. The data available indicate that violations of check hold provisions that would affect fund availability are relatively infrequent. However, we cannot be certain about the actual frequency of these violations because we believe that the regulators have not always done enough in their compliance examinations to be confident that all violations have been identified.

The current FFIEC examination guidelines for Reg CC are extensive and detailed. As most regulators have chosen to permit discretion with regard to adherence to these guidelines, a wide gap exists between the examination procedures developed by FFIEC and the procedures used by examiners. Of the five financial institution regulators, only FRB consistently followed the examination procedures established by FFIEC in the two field offices that we reviewed. We recognize that current FFIEC examination procedures are extremely detailed and testing of the different types of check holds may be time-consuming to complete. We do not suggest that all FFIEC examination guidelines must be used in every compliance examination; however, we do believe that, at a minimum, institutions' check holds must be tested to some extent to ensure that their practices conform to their policies and are in compliance with the applicable funds availability provisions. The examination procedures

followed by most regulators in the reviewed offices assessed the adequacy of the institutions' policies but failed to test institutions' practices. Furthermore, we believe that better documentation of the evidence that examiners used in reaching compliance conclusions is necessary for both effective supervisory review and support for EFAA compliance.

We also found that documentation of the procedures examiners follow in reviewing EFAA compliance and supporting their conclusions varied widely and was often limited or nonexistent. Only FRB's files consistently contained adequate documentation. Documentation of procedures followed in examining EFAA compliance is essential to support the examiners' conclusions, to demonstrate due professional care, and to permit adequate supervisory reviews.

Regulators' experiences with Reg CC compliance examinations over the last couple of years tend to demonstrate that exorbitant check holds are no longer being placed on deposited funds. Therefore, we believe regulators should use that experience to identify specific examination procedures that would provide assurance of Reg CC compliance but would not be overly burdensome to them.

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## Recommendations

For better administration of EFAA, we recommend the following:

- The Federal Reserve Board, the Comptroller of the Currency, the Chairman of the Federal Deposit Insurance Corporation, the Director of the Office of Thrift Supervision, and the Chairman of the National Credit Union Administration should collectively evaluate their examination experience under the act and review the FFIEC uniform examination guidelines to identify procedures that they consider essential for assessing compliance with EFAA's funds availability provisions. These procedures should include guidance on (1) the extent of testing of various types of transactions needed to ascertain compliance and (2) the type and extent of documentation needed to support the examiner's conclusions and facilitate supervisory review. The procedures deemed essential should then be incorporated into each agency's compliance examination handbook or manual, and examiners should be required to use them during subsequent examinations.
- The Federal Reserve Board should issue supplementary guidance that highlights and illustrates the most frequently violated EFAA provisions to enhance financial institutions' compliance with EFAA.

## Agency Comments and Our Evaluation

The five federal financial institution regulators were asked to comment on our draft report. FRB commented on our recommendations to improve examination procedures among regulators and provide supplementary guidance on frequently violated provisions of the act.

In response to the first recommendation, FRB stated plans to continue its implementation of comprehensive examination procedures and agreed to work with other regulatory agencies in strengthening their examination programs. Additionally, FRB agreed with our recommendation to provide supplementary guidance to financial institutions by agreeing to work with the other federal regulators, under the auspices of FFIEC, to develop and provide institutions with guidance to facilitate compliance with frequently violated provisions of EFAA.

The other four regulators agreed to work collectively to evaluate their examination experience and develop appropriate examination procedures to adequately assess financial institutions' check hold practices.

FDIC recognized the importance of testing and stated its plans to remind examiners that testing of check holds is required. However, FDIC stated that it relies on the integrity and judgment of individual examiners as to the extent of supporting documentation that they deem appropriate. Nevertheless, FDIC agreed to work with the other federal regulators to establish appropriate uniform examination guidance.

OTS described its approach whereby examiners focus on assessing compliance management activities by reviewing policies and procedures rather than individual transactions. Therefore, OTS officials believe that specifying the extent of testing would be counterproductive to their agency's examination approach. Furthermore, they believe that the issue of documentation in support of conclusions reached should be handled separately by each regulatory agency. Even with these reservations, OTS stated it would work with the other regulators to evaluate the uniform examination guidance.

OCC and NCUA were in general agreement with both of our recommendations to improve compliance examination procedures and to provide clarifying guidance on frequently violated provisions of the law and regulation.

We are encouraged that the five federal regulators have agreed to work together on the uniform examination guidance to ensure that EFAA compliance examinations include testing of institutions' check practices and

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**Chapter 3**  
**Compliance With Availability Schedules Is**  
**Generally High, but Improvements Are**  
**Needed in Examinations**

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documentation of the basis for examiners' conclusions. However, we are somewhat concerned about the reluctance of FDIC and OTS to approach the uniform guidelines more positively with regard to testing and documentation. We are not suggesting the guidelines specify the number of transactions to be tested and documented. Instead, we believe the regulators' collective experience with EFAA should allow them to agree on general examination guidance that addresses the need for testing and documentation to ensure that institutions' actual practices comply with EFAA provisions.

# Potential Check Fraud Risk Prompts Action or Improved Procedures and Legislative Change

When Congress enacted EFAA, it was aware of the financial institution industry's concern that requiring financial institutions to make funds available more expeditiously might increase exposure to check fraud losses. Consequently, EFAA included a temporary, 2-year availability schedule to allow time for improvements to the check collection and return system. EFAA also gave FRB authority to improve the check collection and return system and to suspend the availability schedule requirements that caused unacceptable levels of check fraud loss to financial institutions.

FRB has acted to make the check collection and return system more efficient, and it continues to explore other improvements. Among the most significant improvements to the system achieved through FRB's efforts is a more efficient handling of check returns. The improved handling has checks returned by the payor institution directly to the institution in which the check was first deposited. Previously, checks were returned through each institution involved in the forward collection process, which may have included numerous endorsements. FRB has also established endorsement standards to facilitate the new check return process. FRB, along with various industry representatives, is also working on strategies to establish a nationwide electronic clearinghouse<sup>1</sup> as a means to improve the Nation's payments system. FRB is also studying problems that need to be resolved to establish a more efficient system for processing ATM deposits, thereby enabling institutions to comply with EFAA provisions with less risk of check fraud loss.

FRB officials have testified before Congress on industry concerns about the potential increased exposure to check fraud loss believed attributable to EFAA payment schedules, and FRB supports amendments to EFAA to alleviate those concerns. FRB has not, however, exercised its authority to suspend EFAA schedule requirements. To do so, FRB is required to present evidence that EFAA requirements have caused unacceptable fraud losses. Data needed as evidence of such unacceptable losses have not been collected by FRB or provided to FRB by institutions that have raised concerns about check fraud losses.

In our review of the issue of check fraud, we observed the check collection and return processes of FRB and private clearinghouses, and we contacted 33 financial institutions that were willing to share information about their checking operations and fraud exposure. On the basis of our

<sup>1</sup>Electronic clearinghouse is defined as a facility or mechanism for converting paper-based payments (checks or drafts) to electronic form for presentment to the paying institution.

observations and the institutions' information, we confirmed that check processing procedures have improved since EFAA's passage. Nevertheless, the industry remains concerned about exposure to fraud because of the shorter permanent availability schedule requirements, particularly the 2-day requirement for local checks. From our contacts with these institutions and our discussions with various industry representatives, we also confirmed that verifiable data on losses directly attributable to Reg CC are not currently available. Furthermore, the institutions we contacted generally shared the view that data necessary to demonstrate that unacceptable check fraud losses have resulted from EFAA cannot be collected cost effectively.

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### Check Fraud Exposure Increased Under Permanent Schedules

We did not determine whether all available technological and operational procedures that could improve the check collection and return process have been fully explored by FRB and the financial institutions industry. Nor did we determine whether the institutions were fully utilizing available EFAA exception provisions, which allow extended holds for certain types of checks, like large dollar or suspicious checks to reduce institutions' exposure to fraud. We were, however, better able to understand the concerns of institutions that believe check fraud exposure has increased because of EFAA's permanent availability schedule requirements.

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### FRB's Returned Check Survey Shows Fraud Exposure

To determine the effect of Reg CC improved procedures on the elapsed time between the deposit of a check at the depository bank and receipt by the depository bank of the returned check if it is dishonored, FRB launched a data collection effort on returned checks processed by District Federal Reserve Banks<sup>2</sup> in late 1989 and early 1990. In this effort FRB examined a total of 1,000 returned checks—50 percent local, 50 percent nonlocal. The survey illustrated the potential difficulty in processing return items within the time periods allowed by the permanent schedule. FRB found the following:

- Under the temporary schedule, 63 percent of local returns and 92 percent of nonlocal returns were delivered to the depository bank by the day that funds were to be made available for withdrawal.
- Under the permanent schedule (had it been effective at that time), only 3 percent of local checks and 73 percent of nonlocal checks would have

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<sup>2</sup>The Federal Reserve System includes District Federal Reserve Banks throughout the country that, among other operations, provide check collection and return services to depository institutions.

been returned by the day funds were to be made available for withdrawal.

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### Check Clearing Process Indicates Increased Check Fraud Risk

We visited several clearinghouses and a Federal Reserve Bank and observed their check collection and return processes. Officials of the clearinghouses explained to us that whether the check is processed through a clearinghouse or one of the Federal Reserve Banks, the depository institution will generally not know whether local checks will be honored until the third business day after the deposit was made. The mechanics of the check collection and return system, as explained by these officials and as we observed, support the view that the permanent schedule makes financial institutions somewhat vulnerable to check fraud losses from local check returns. The basic contention is that unless specially handled, local checks are generally returned after the mandated hold period has elapsed. These officials did explain, however, that payor institutions will sometimes try to reduce their fraud exposure by sending electronic information or facsimiles of large dollar or suspicious checks to depository institutions in advance of the physical check return process. However, such special handling did not always provide notification of dishonored checks within 2 days, the permissible hold period for local checks. Furthermore, special handling was not feasible for the high volumes of checks processed daily in the current check collection and return system.

Given that EFAA requires funds from local checks to be made available at the opening of business on the second business day following the day of deposit, the clearinghouse and FRB officials believed that institutions could suffer a loss of funds. Under the shorter permanent schedule for local checks, deposited checks that are returned on the day the hold expires usually are not deducted from the customer's available balance by the start of the business day. For example, table 4.1 illustrates how an unscrupulous person could deposit a fraudulent \$1,000 check and withdraw the funds before the depository institution could ascertain that it was fraudulent. Consequently, the depository institution could suffer a loss.

**Chapter 4  
Potential Check Fraud Risk Prompts Action  
or Improved Procedures and  
Legislative Change**

**Table 4.1: Local Check Risk Exposure Under the EFAA Permanent Schedule for a \$1,000 Check**

Day	EFAA requirement	Check process through the clearinghouse	Check process through the Federal Reserve	Exposure to fraud
Monday	Check deposited	Check deposited	Check deposited	None
Tuesday (Day 1)	First \$100 is made available for check writing and cash withdrawal.	Check presented to account holding bank by exchange at clearinghouse.	Check presented to account holding bank by Federal Reserve.	\$100
Wednesday (Day 2)	Balance made available for check writing, \$400 more made available for cash withdrawal.	Check processed at account holding bank, return checks sent to clearinghouse.	Check processed by account holding bank and returned to the Federal Reserve.	Entire amount of check through check writing, \$500 through cash withdrawal.
Thursday (Day 3)	Balance made available for cash withdrawal. <sup>a</sup>	Return items processed and accounts debited.	Federal Reserve returns to depository institution.	Entire amount of \$1,000 check if withdrawn prior to account debit.

<sup>a</sup>Under the permanent schedule, a special Reg CC rule permits financial institutions to extend the availability schedule by 1 day for certain cash or similar withdrawals. The purpose of this rule is to minimize fraud exposure by allowing financial institutions to limit the amount of cash that can be withdrawn on the day that the check hold expires.

## Legislative Amendments Proposed to Alleviate Check Fraud Exposure

As demonstrated by FRB's survey of returned checks and the check collection and return process, the issue of local check processing is a big concern of the financial industry. In a series of reports to Congress, FRB has said that all of the technological improvements needed to protect financial institutions from check fraud have not occurred. Further, FRB noted that such improvements were not likely to occur in the foreseeable future as they were too costly to implement. Given these factors, in its March 1990 report to Congress FRB recommended several legislative amendments to reduce potential risk to financial institutions and help them comply with EFAA's availability requirements. Table 4.2 discusses supporting and opposing arguments regarding the major FRB proposed amendments. We compiled these arguments using information obtained through interviews with various FRB, industry, and consumer representatives as well as through other testimonial evidence, including congressional hearings.

To date, only one amendment involving nonproprietary ATMs (i.e., those owned by other institutions) has been passed by Congress. However, unlike FRB's proposed amendment, which advocated a permanent change, the passed amendment sought to reduce risks to financial institutions by allowing nonproprietary ATM deposits to be treated as non-local checks for only 2 years from the date of enactment of the amendment, November 28, 1990.

**Chapter 4  
Potential Check Fraud Risk Prompts Action  
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**Table 4.2: EFAA Legislative Amendments Recommended by FRB**

<b>Amendment</b>	<b>Arguments for</b>	<b>Arguments against</b>
Modify the permanent schedule to reinstate 3-day availability for local checks.	Virtually no local returned checks are received by the depository bank prior to the funds availability requirements of the permanent schedule.	The financial industry has failed to demonstrate that this provision has caused "unacceptable losses," as required by EFAA for suspension of availability schedules; therefore, the law should remain unchanged.
Consistent with the temporary schedule, continue to treat nonproprietary ATM deposits as nonlocal checks under the permanent schedule. (NOTE: This amendment was passed with a 2-year restriction.)	A viable solution to address the ATM processing limitations has not been identified.	The industry's failure to implement operational changes needed to provide hold data to the account holding bank does not warrant forcing consumers to accept greater delays in funds availability.
Expand the scope of safeguard exception holds to include checks subject to next-day availability (e.g., government, cashier's, and certified checks).	Financial institutions should be permitted to place the same exceptions on these checks as local and nonlocal checks to exposure to fraud losses (due to forgery and counterfeiting).	Next-day availability was provided for these checks because of their limited risk. The small risk weighed against the customer's extra expense in purchasing such checks (thought to be as good as cash) fails to justify expansion of the exception holds.
Provide greater flexibility in giving notice of exception holds to customers.	Would reduce the burden on financial institutions that currently have to provide notice to customers even for repeatedly invoking the same exception.	May cause confusion among customers if they are not informed of each hold as it is placed.
Limit the next-day requirement for Treasury and on-us checks to checks deposited at staffed teller facilities.	Banks and ATM networks say they are generally unable to verify the contents of deposits at proprietary ATMs in time to provide next-day availability for these checks.	Checks deposited into proprietary ATMs <sup>a</sup> can be immediately processed by the owner of the ATM just as if they were deposited at a live teller window.
Resolve operational and disclosure difficulties created by payable through checks. <sup>b</sup>	Will allow for more rapid check processing by using automated means to determine whether a check is local or nonlocal.	The new conspicuous labeling requirement adopted by FRB in August 1989 facilitates the identification of payable through share drafts.

<sup>a</sup>A proprietary ATM is one that is located at or adjacent to a branch of the receiving institution or in close proximity; or owned by, operated exclusively for, or operated by the receiving institution.

<sup>b</sup>Payable through checks are those that are written on one institution but paid through another (e.g., a credit union share draft). Operational difficulties occur because the identifying numbers on the check used in automated processing are those of the payable through institution (bank), rather than the paying institution (credit union). The location of the credit union should determine whether the check is local or nonlocal and the type of hold to be applied rather than the location of the payable through bank.

As provided by EFAA, FRB may suspend provisions of EFAA availability schedules if it has evidence that financial institutions are experiencing an unacceptable level of check fraud losses related to those EFAA provisions. FRB was concerned that waiting until unacceptable EFAA-related check fraud could be demonstrated would be too late to prevent significant fraud losses to the industry. Therefore, FRB proposed an amendment to this authority that, if passed, would ease the requirement to prove unacceptable losses attributable to EFAA. The amendment would require FRB to show a pattern of significant increases in fraud-related losses. It also would require Congress to act to overturn an FRB suspension rather than to ratify it. Currently, the opposite condition exists—

Congress must approve any suspension of the schedule by FRB within 45 days or it lapses.

In the absence of evidence of fraud loss, consumer groups did not believe many of the amendments were justified and, furthermore, believed that such amendments would tend to weaken consumer protections already enacted into law. They said that EFAA did not seek to totally eliminate risk but rather to protect consumers without significantly increasing institutions' risk.

## Data to Substantiate EFAA-Related Check Fraud Loss Is Lacking

In its March 1990 response to Congress, FRB said that to demonstrate that particular provisions of EFAA resulted in high levels of losses to the industry would require loss data collected on (1) the class of check deposited (for example, government checks, official checks, local checks, or nonlocal checks); (2) the availability that had been provided (distinguishing availability attributable to the bank's policy rather than to EFAA's requirements); and (3) the means of deposit (for example, at a nonproprietary ATM or with a teller). According to FRB, few institutions account for check losses with this detail; therefore, collection of fraud data would require major accounting changes at institutions and a significant effort by FRB to gather additional data.

We asked the 33 financial institutions we contacted for information about losses that they have incurred from check fraud due to EFAA and their views on the feasibility of establishing a data collection system to monitor EFAA-related fraud loss. Their responses generally indicated that while they were concerned about fraud exposure under EFAA, they believed that establishment of a data collection system would not be cost-effective. Furthermore, the general inability of institutions contacted to identify losses attributable to EFAA helped us to confirm that, for the most part, verifiable information about EFAA-related check losses is not currently available.

Although the institutions we contacted believe that their exposure to fraud has increased under the permanent funds availability schedule, which became effective on September 1, 1990, most of them did not consider their EFAA-related losses to date to be very significant or they did not identify any EFAA-related losses. However, 14 of the 33 institutions we contacted did attempt to quantify losses that they believed could be attributed to EFAA requirements. Losses described by the 14 institutions ranged from \$80 (by a bank with assets over \$50 million) to \$20 million (by a money center bank with assets over \$50 billion). We could not

make meaningful comparisons of loss figures described to us or make general conclusions about EFAA losses because of the limited number of institutions furnishing fraud loss data and our inability to verify the data furnished, as well as the wide range of reported fraud losses.

Most of the institutions we contacted did not favor the establishment of a data collection system to monitor EFAA-related check fraud losses. Only nine institutions believed that establishing a data collection system would be cost effective. One of the nine said that while such a system could substantiate the need for amendments to EFAA, the costs associated with reconfiguring the institution's accounting system and creating historical trends to demonstrate EFAA's impact would be quite substantial.

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## Conclusions

On the basis of our observations of FRB and private clearinghouse check collection and return processes and others' descriptions of these processes, we believe that some exposure to check fraud does exist. However, we could not determine the degree to which the exposure exists.

In general, financial institutions we contacted during our survey said that it was not cost beneficial or practical for them to establish systems to collect information on fraud losses attributable to EFAA provisions. Therefore, for the most part, the EFAA risk exposure has not been quantified in any verifiable manner in these institutions. At the same time, these institutions, along with the financial institutions industry, have expressed concern that EFAA compliance increases their exposure to check fraud losses.

We did not determine the degree to which the industry is taking advantage of technological or operational opportunities or utilizing available exception provisions to EFAA availability schedules. However, until they can demonstrate that losses have actually been incurred as a result of EFAA, institutions will have to alleviate their concerns about fraud loss exposure by using EFAA exception holds and/or making their check collection processes more efficient.

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## Agency Comments and Our Evaluation

FRB comments expressed disappointment that we did not advocate passage of its proposed legislative amendments, particularly those intended to reduce financial institutions' risk of check fraud loss. FRB urged us to

support those proposals so that congressional action can be taken prospectively rather than waiting until institutions incur unacceptable levels of check fraud loss. FRB suggested that our report implies that Congress should not act until such losses can be demonstrated.

As stated in our conclusions, we recognize that institutions are somewhat vulnerable to check fraud losses, particularly in situations like local check processing when institutions may be required to make funds available to customers before they know whether the checks will be honored. While we recognize the vulnerability, we could not determine its extent or the degree to which it could be alleviated through EFAA check holds, technological advances, or operational changes. Neither the proponents or opponents of the FRB sponsored amendments could provide quantifiable data, beyond anecdotal evidence, to support their views. Therefore, we disclosed the perspectives of those affected by EFAA so that Congress could have the best information available to consider these amendments or others intended to reduce institutions' vulnerability to check fraud losses.



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# Regulatory Agencies and Industry Groups Contacted During This Study

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## Federal Regulatory Agencies

Federal Reserve Board  
Federal Deposit Insurance Corporation  
Office of the Comptroller of the Currency  
Office of Thrift Supervision  
National Credit Union Administration

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## Financial Trade Associations

American Bankers Association  
Credit Union National Association  
Consumer Bankers Association  
Independent Bankers Association of America  
United States League of Savings Institutions  
California League of Savings Institutions  
Electronic Funds Transfer Association

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## Clearinghouse Associations

Chicago Clearing House Association  
New York Clearing House Association  
California Bankers Clearing House

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## Consumer Advocate Groups

Consumer Federation of America  
Consumers Union  
U.S. Public Interest Research Group

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## Professional Services Organizations

Bank Administration Institute  
J.D. Carreker and Associates, Inc.

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## ATM Networks

Cash Station, Inc.  
Money Access Service

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# Expedited Funds Availability Examination Checklist

## I. OPERATIONS

### A. Date of Deposit

- |  |     |    |
|--|-----|----|
| 1. Does the bank consider every day except Saturday, Sunday, or Federal Holidays, as a "business day?" [229.2(g)]  | Yes | No |
| 2. Does the bank consider as a "banking day" those business days upon which an office of the bank is open for substantially all of its business? [229.2(f)]  | Yes | No |
| 3. Does the bank have a cut-off, for receipt of deposits, of 2 p.m. or later for bank offices and 12:00 noon or later for ATMs? [229.19(a)(5)(ii)]   | Yes | No |
| 4. Does the bank comply with the following rules in determining when funds are considered to have been deposited?  | Yes | No |
| a. Deposits over the counter or at ATMs are considered deposited when "received." [229.19(a)(1)]   | Yes | No |
| b. Mail deposits are considered deposited when they are received by the mail room of the bank. [229.19(a)(2)]  | Yes | No |
| c. Deposits in a night depository, lock box, or similar facility are considered received when the deposits are removed from the facility and are available for processing. [229.19(a)(3)]  | Yes | No |
| d. Deposits at an off-premise ATM (not within 50 feet of the bank) that is not serviced more than twice a week are considered received as of the date the deposits are removed from the ATM by the bank. [229.19(a)(4)]                                  | Yes | No |
| 5. Does the bank consider deposits made on a nonbanking day to have been received no later than the next banking day? [229.19(a)(5)(i)]  | Yes | No |
| 6. When funds must be available on a given "business day," does the bank make the funds available at the later of 9 a.m. or at the time the bank's teller facilities (including ATMs) are available for account withdrawals? [229.19(b)]                 | Yes | No |
| 7. If the bank limits cash withdrawals, does the bank make \$400 available for cash withdrawals no later than 5:00 pm on the appropriate business day (second day for local checks, fifth for nonlocal checks) following the day of deposit? [229.12(d)] | Yes | No |

### B. Required Next Day Availability

- |   |     |    |
|---|-----|----|
| 1. Does the bank make funds from the following types of deposits available for withdrawal no later than the first business day following the date of deposit: |     |    |
| a. Electronic payments. [229.10(b)]   | Yes | No |
| b. Checks drawn on the U.S. Treasury and deposited to the payee's account. [229.10(c)(1)(i)]  | Yes | No |
| c. "On Us" checks or checks that are drawn on and deposited in branches of the same bank in the same state or check processing region. [229.10(c)(1)(vi)]     | Yes | No |

(continued)

**Appendix II  
Expedited Funds Availability  
Examination Checklist**

**I. OPERATIONS**

2. Does the bank make funds from the following deposits available no later than the first business day after the day of deposit, if the deposit is made in person to a bank employee, or no later than the second business day if the deposit is not made in person to a bank employee:		
a. Cash Deposits. [229.10(a)(1),(2)]	Yes	No
b. U.S. Postal Service money orders deposited in an account held by the payee of the check. [229.10(c)(1)(ii), 229.10(c)(2)]	Yes	No
c. Checks drawn on a Federal Reserve Bank or Federal Home Loan Bank deposited in an account held by the payee of the check. [229.10(c)(1)(iii), 229.10(c)(2)]	Yes	No
d. Checks drawn by a state or local governmental unit and deposited:		
i. in an account held by the payee of the check [229.10(c)(1)(iv)(A), 229.10(c)(2)];	Yes	No
ii. in a depository bank located in the same state as the governmental unit issuing the check [229.10(c)(1)(iv)(B)], [229.10(c)(2)]; and	Yes	No
iii. accompanied by a special deposit slip (if required by the bank to make the funds available on the next business day). [229.10(c)(1)(iv)(D)], [229.10(c)(3)]	Yes	No
e. Cashier's, certified checks, and teller's checks (as defined in section 229.2) deposited in an account held by the payee of the check when:		
i. the check is accompanied by a special deposit slip (if required by the bank to make the funds available on the next business day)? [229.10(c)(1)(v)(C)], [229.10(c)(3)]	Yes	No
3. If the bank requires the special deposit slips, for questions 2(d) and 2(e) above does it provide the slip to its customers, or inform its customers how to prepare or obtain the slips? [229.10(c)(3)(ii)]		
Are the special deposit slips reasonably available? [229.10(c)(3)(ii)]	Yes	No
4. Is the first \$100 of a customer's daily aggregate deposits of checks not subject to the next-day availability rules, available on the next business day? [229.10(c)(1)(vii)]		
Yes	No	
5. Is the \$100 in addition to other deposited amounts with required next-day availability? [229.10(c)(1)(vii)]		
Yes	No	
<b>C. Local Checks and Certain Other Deposits</b>		
1. Are funds from local checks generally available no later than the second business day after the day of deposit? [229.12(b)(1)]		
Yes	No	
2. If a bank limits cash withdrawals, [229.12(d)]		
a. Is the \$100 available on the next business day after the day of deposit for withdrawal in cash or by check?	Yes	No
b. Is the \$400 available for cash withdrawal some-time before 5:00 pm on the second business day after the day of deposit?	Yes	No
c. Are any remaining funds available for withdrawal the business day after the \$400 was made available?	Yes	No

(continued)

**Appendix II  
Expedited Funds Availability  
Examination Checklist**

**I. OPERATIONS**

3. For Treasury checks and U.S. Postal Money Orders that do not meet the criteria for next-day (or second day) availability, does the bank make funds available no later than the second business day after the date of deposit? [229.12(b)(2) and (4)]      Yes      No

4. Are funds deposited by cash or check at a nonproprietary ATM available no later than the fifth business day after the banking day of deposit? [229.12(f)]      Yes      No

**D. Nonlocal Checks**

1. Are funds from nonlocal checks generally available no later than the fifth business day after the day of deposit? [229.12(c)(1)]      Yes      No

2. If the bank is located in a city listed in Appendix B (of Regulation CC), does it have procedures to make funds for certain nonlocal checks available on a shorter schedule as required by the Appendix? [229.12(c)(2)]      Yes      No

3. If a bank limits cash withdrawals, [229.12(d)]

a. Is \$100 available on the next business day after the day of deposit for withdrawal in cash or by check?      Yes      No

b. Is \$400 available for cash withdrawal sometime before 5:00 pm on the fifth business day after the day of deposit?      Yes      No

c. Are any remaining funds available for cash withdrawal the business day after the \$400 was made available      Yes      No

**E. Payable Through Checks**

1. Does the bank's policy distinguish between local and nonlocal checks (are funds from local and non-local checks available on the second business day following the day of deposit)? [229.16(b)(2), footnote 3a]      Yes      No

2. If local and nonlocal checks are treated differently,

a. Does the policy state that payable through checks will be treated as local or nonlocal based on the location of the bank where the check is payable? [229.16(b)(2)]      Yes      No

b. Does the policy either: [229.16(b)(2), footnote 3(a)]

(1) Describe how the customer can determine whether the checks will be treated as local or nonlocal or,      Yes      No

(2) State that special rules apply and that the customer may ask about the availability of these checks?      Yes      No

(continued)

**Appendix II  
Expedited Funds Availability  
Examination Checklist**

**I. OPERATIONS**

**Extended Holds**

F. Case-by-Case Holds

1. Does the bank's specific availability policy disclosures indicate that case-by-case holds may be placed? [229.16(c)(1)]	Yes	No
If yes, does the disclosure:		
a. state that the bank may extend the time period in which deposits may be available for withdrawal? [229.16(c)(1)(i)]	Yes	No
b. provide the latest time a deposit will be available for withdrawal, if the availability time frame is extended? [229.16(c)(1)(i)]	Yes	No
c. state that the bank will notify the customer if funds from a particular deposit will exceed the time period outlined in the bank's funds availability policy? [229.16(c)(1)(ii)]	Yes	No
d. encourage customers to ask when particular deposits will be made available for withdrawal? [229.16(c)(1)(iii)]	Yes	No
2. When case-by-case holds are placed, does the bank provide the customer with a written notice of the hold? [229.16(c)(2)]	Yes	No
3. Does the notice include:		
a. the customer's account number; [229.16(c)(2)(i)(A)]	Yes	No
b. the date and amount of the deposit; [229.16(c)(2)(i)(B)]	Yes	No
c. the amount of the deposit that is being delayed; [229.16(c)(2)(i)(C)]	Yes	No
d. the day the funds will be available for withdrawal. [229.16(c)(2)(D)]	Yes	No
4. Does the bank provide the notice at the time the deposit is made, if the deposit is made to an employee of the depository bank? [229.16(c)(2)(ii)]	Yes	No
5. If the notice is not given at the time of deposit, does the depository bank mail or deliver the notice to the customer not later than the first business day after the day of the deposit? [229.16(c)(2)(ii)]	Yes	No
6. If the bank does not provide the notice at the time of deposit, does it refrain from charging the customer overdraft or return check fees if:		
a. the overdraft or other fee would not have occurred if the deposited checks had not been delayed; and	Yes	No
b. the deposited check was paid by the paying bank; check fees? [229.16(c)(3)]	Yes	No
7. If the bank does not provide the notice at the time of deposit and charges overdraft fees, does it notify the customer of the right to a refund of such fees and how to obtain the refund? [229.16(c)(3)]	Yes	No
8. Does the bank refund the fees if the conditions listed in question 6 above are met and the customer requests a refund? [229.16(c)(3)]	Yes	No

(continued)

**Appendix II  
Expedited Funds Availability  
Examination Checklist**

**I. OPERATIONS**

**G. Exception Based Holds**

- |   |     |    |
|---|-----|----|
| 1. When invoking an exception hold for other than new accounts, does the bank provide the customer with a written notice which includes:  |     |    |
| a. the customer's account number; [229.13(g)(1)(i)]   | Yes | No |
| b. the date and amount of the deposit; [229.13(g)(1)(ii)]   | Yes | No |
| c. the amount of the deposit that is being delayed; [229.13(g)(1)(iii)]   | Yes | No |
| d. the reason the exception was invoked; [229.13(g)(1)(iv)]   | Yes | No |
| e. the day the funds will be available for withdrawal (unless the emergency conditions exception is invoked and the bank does not know when the funds will become available)? [229.13(g)(1)(v)]         | Yes | No |
| 2. Does the bank refrain from delaying funds availability beyond a reasonable time period? [Note: Five days for local checks and six days for nonlocal checks is considered reasonable.] [229.13(h)(4)] |     |    |

**Exceptions**

**H. New Accounts [229.13(a)]**

- |  |     |    |
|--|-----|----|
| 1. Does the bank's definition of a new account comply with the definition under section 229.13(a)(2)? [Note: If a customer has had another transaction account at the bank within the thirty days prior to opening an account, the customer does not qualify for the "new account" exception.] | Yes | No |
| 2. If the bank's definition is different, does it delay availability to new account holders beyond the limits set forth in the regulation?   | Yes | No |
| 3. Do bank disclosures accurately reflect the bank's practice for making deposited funds available for new accounts?   | Yes | No |
| 4. Do cash deposits made in person to a bank employee become available for withdrawal on the first business day following the day of deposit? [229.13(a)(1)(i), 229.10(a)(1)]  | Yes | No |
| 5. Are cash deposits not made in person to a bank employee available for withdrawal on the second business day following the day of deposit? [commentary to 229.13(a)(1), 229.10(a)(2)]  | Yes | No |
| 6. Are electronic transfers into new accounts available for withdrawal on the business day following the day the transfer is received? [229.13(a)(1)(i), 229.10(b)]  | Yes | No |

(continued)

**Appendix II  
Expedited Funds Availability  
Examination Checklist**

**I. OPERATIONS**

7. Is the first \$5,000 from any of the following types of check deposits available for withdrawal from a new account not later than the first business day after the day of the deposit, if the deposits meet the requirements of section 229.10(c)\*: [229.13(a)(1)(ii)]

- |   |     |    |
|---|-----|----|
| a. Treasury checks [229.10(c)(1)(i)]                                    | Yes | No |
| b. U.S. Postal Service money orders [229.10(c)(1)(ii)]                  | Yes | No |
| c. Federal Reserve or Federal Home Loan Bank checks [229.10(c)(1)(iii)] | Yes | No |
| d. State or local government checks [229.10(c)(1)(iv)]                  | Yes | No |
| e. Cashier's certified and Teller's checks [229.13(a)(1)(iii)]          | Yes | No |
| f. Traveler's checks [229.13(a)(1)(iii)]                                | Yes | No |

\*See section I.B. of the checklist

8. Is the amount of any deposit type listed in question 7 exceeding \$5,000 available for withdrawal no later than the ninth business day following the day of deposit? [229.13(a)(1)(ii)]

Yes No

**I. Large Deposits [229.13(b)]**

1. If the bank invokes the large deposit rule, does it do so only to that portion of the aggregate local and nonlocal check deposits which exceed \$5,000 on any one banking day? [229.13(b)]

Yes No

2. Does the financial institution refrain from applying this exception to deposits made in cash, by electronic payment, or to checks which must receive next-day availability under Section 229.10(c)? [See commentary to 229.13(b)]

Yes No

3. Does the bank provide customers with a written notice of the longer delay? [229.13(g)(1)]

Yes No

a. Is the notice: [229.13(g)(2)] provided at the time of the deposit, when the deposit is received in person by an employee of the bank, or

Yes No

b. mailed on or before the first business day after the day the bank learns of the facts giving rise to the exception?

Yes No

**J. Redeposited Checks [229.13(c)]**

1. Does the bank refrain from applying the redeposited exception to:

a. checks which are returned due to a missing endorsement and are subsequently endorsed and redeposited? [229.13(c)(1)]

Yes No

b. checks which were returned because they were post-dated, but are not postdated when redeposited? [229.13(c)(2)]

Yes No

2. Does the bank consider the day the check was redeposited to be the day of deposit when determining when funds must be made available for withdrawal? [Commentary to 229.13(c)]

Yes No

(continued)

**Appendix II  
Expedited Funds Availability  
Examination Checklist**

**I. OPERATIONS**

**K. Repeated Overdrafter Exception [229.13(d)]**

- |  |  |     |    |
|--|--|-----|----|
| 1. Does the bank impose longer holds for depositors who have a history of overdrafts?  |  | Yes | No |
| 2. Does the bank invoke the repeated overdraft exception only when the account balance is negative (or would have been negative had checks or other charges been paid):  |  |     |    |
| a. six or more times during the preceding 6 months, [229.13(d)(1) or;  |  | Yes | No |
| b. two or more times during the preceding 6 months, if the amount of any negative balance would have been \$5,000 or more. [229.13(d)(2)]  |  | Yes | No |
| 3. Is this practice articulated in the bank's written policy and initial disclosure statement? [229.16(a)]   |  | Yes | No |
| 4. When the bank imposes the longer delay period, is the depositor notified of the reason, in writing, at the time of deposit? If not, is a notice mailed on or before the first business day after the day of the deposit or the day the bank learns of the facts giving rise to the exception? [229.13(g)] |  | Yes | No |
| 5. Does the bank return the account to the normal availability schedule when the account is no longer repeatedly overdrawn? [Note: Banks may use this exception for six months after the last overdraft that makes the depositor a "repeated overdrafter" (See K.2. above). [229.13(d)]]                     |  | Yes | No |

**L. Reasonable Cause to Doubt Collectibility [229.13(e)]**

- |  |  |     |    |
|--|--|-----|----|
| 1. Does the bank refrain from applying the reasonable cause exception to: [229.13(e)(1)]   |  |     |    |
| a. U.S. Treasury checks;   |  | Yes | No |
| b. U.S. Postal money orders;   |  | Yes | No |
| c. state and local government checks;  |  | Yes | No |
| d. "on us" checks?   |  | Yes | No |
| 2. When the bank invokes a reasonable cause exception, does it provide the customer with a written notice of exception at the time the deposit was made, if the deposit was made in person to an employee of the bank? [229.13(g)(2)]                  |  | Yes | No |
| 3. If the deposit was not made in person to an employee of the bank, or if the hold was placed because of information learned subsequent to the receipt of the deposit, does the institution mail the exception notice to the customer? [229.13(g)(2)] |  | Yes | No |
| 4. Does the bank retain copies of each reasonable cause exception notice, along with a brief statement of the facts which lead to the hold, for a period of two years? [229.13(g)(3)]  |  | Yes | No |
| 5. Does the depository bank refrain from invoking the reasonable cause exception based on the race or national origin of the depositor or the class of the check? [229.13(e)]  |  | Yes | No |

(continued)

**Appendix II  
Expedited Funds Availability  
Examination Checklist**

**I. OPERATIONS**

6. Does the bank refrain from assessing a fee for any subsequent overdraft, returned check, or other unpaid charge (or advise customers of their right to a refund of such fees and refund them upon request) if all of the following are met:

- |   |     |    |
|---|-----|----|
| a. the depository bank extended the availability period based on its belief that the check was uncollectible [229.13(e)(1)];  | Yes | No |
| b. the depositor was not provided with the written notice required by section 229.13(g)(1) at time of deposit [229.13(e)(2)]; | Yes | No |
| c. the overdraft or return would not have occurred if the availability period had not been extended [229.13(e)(2)(i)]; and    | Yes | No |
| d. the deposited check was finally paid by the paying bank? [229.13(e)(2)(ii)]  | Yes | No |

7. Does the exception notice inform the customer where to direct a request for a refund of the overdraft fees? [229.13(e)(2)] Yes No

**M. Emergency Conditions [229.13(f)]**

1. Does the bank refrain from imposing emergency condition holds on checks subject to next-day availability under 229.10(c)? [Commentary to 229.13(f)] Yes No

2. Does the bank invoke the emergency conditions exception only in the following circumstances and when the bank has exercised necessary diligence as circumstances require:

- |   |     |    |
|---|-----|----|
| a. an interruption of communications or computer or other equipment; [229.13(f)(1)] | Yes | No |
| b. suspension of payments by another bank; [229.13(f)(2)]                           | Yes | No |
| c. war; or [229.13(f)(3)]   | Yes | No |
| d. an emergency condition beyond the control of the bank? [229.13(f)(4)]            | Yes | No |

3. Does the bank make funds available for withdrawal no later than a reasonable period after the emergency has ended or within the time period established by the temporary and permanent schedules, whichever is later? [229.13(h)(3)] (As stated in the commentary to 4.229.13(h)(4), a reasonable period is 5 business days for local checks and 6 for nonlocal checks.) Yes No

4. Does the bank provide customer with a written notice of the longer delay? [229.13(g)(1)] Yes No

5. Is the notice provided at the time of the deposit, if the deposit is received in person by an employee of the bank or is the notice mailed on or before the first business day after the day the bank learns of the facts giving rise to the exception? [229.13(g)(2)] Yes No

(continued)

**Appendix II  
Expedited Funds Availability  
Examination Checklist**

**I. OPERATIONS**

**Miscellaneous**

**N. Calculated Availability**

**Non-consumer Transaction Accounts [229.19(d)]**

- |   |     |    |
|---|-----|----|
| 1. Does the bank calculate funds availability for non-consumer accounts based on a sample of the customer's deposits? If yes, obtain a copy of the bank's formula for determining its availability schedule. Review a sample of checks similar to that used by the bank to calculate funds availability and answer the following: | Yes | No |
| a. Is the sample of checks large enough to accurately utilize the formula?  | Yes | No |
| b. Does the formula accurately represent the average composition of the customer's deposits?  | Yes | No |
| c. Does the specified percentage of available funds appear reasonable? (Is a set percentage available the next business day, with remaining funds available according to the customer's deposit mix?)   | Yes | No |
| 2. Based on the sample, are the terms of availability for the account equivalent or more prompt than the terms outlined in the regulation?  | Yes | No |

**II. PAYMENT OF INTEREST**

Review a copy of the bank's availability schedule for check deposits credited through the Reserve Bank or its correspondent bank. Determine the time that the bank receives provisional credit for check deposits.

- |   |     |    |
|---|-----|----|
| 1. For each interest-bearing transaction account offered by the bank (e.g., NOW accounts, ATS accounts), does the bank begin to accrue interest on the funds deposited no later than the business day on which the bank receives provisional credit for the funds? [Section 229.14] | Yes | No |
|---|-----|----|

**Workpaper Appendix for Districts with Banks Located Outside the Continental United States**

**Deposits at non-continental U.S. offices**

An extension of one day is permitted under certain strictly defined circumstances and for limited types of deposits. If a check is deposited at a bank in Alaska, Hawaii, Puerto Rico or the U.S. Virgin Islands and the paying bank is not located in the same jurisdiction, a one-day extension is permitted for deposits other than those that must be available on the next business day. (Note: This extension applies only to bank offices located outside of the continental United States. Check deposits received at a bank inside the continental United States, but drawn on a bank located outside the United States, such as Alaska, or Hawaii, are not granted the extension.)

- |  |     |    |
|--|-----|----|
| 1. For offices located in Alaska, Hawaii, Puerto Rico and the U.S. Virgin Islands does the bank extend availability for check deposits drawn on banks in other states? [229.11(e)(1)]  | Yes | No |
| 2. If yes,   |     |    |
| a. Is the extension limited to checks drawn on banks in a different state? (A Hawaiian bank could receive a "local" check drawn on a bank in Honolulu or a bank in San Francisco. Only the San Francisco check can be delayed.) [229.12(e)(2)] | Yes | No |
| b. Is the extension limited to one day? [229.12(e)]  | Yes | No |

# Reg CC Violations Cited Most Frequently,<sup>a</sup> Based on Examinations by Bank Regulator (9/1/88 to 6/30/90<sup>b</sup>)

Agency (number of exams)	Number of exams with violation	Percent <sup>c</sup>	Description of provision violated
FDIC (5,396)	309	5.7	Disclose funds availability information at locations where employees accept deposits, on deposit slips and at ATMs.
	160	3.0	Develop procedures and training to ensure compliance with Subpart B of Reg CC.
	147	2.7	Provide next-day availability of the first \$100 from the aggregate deposits of certain checks.
FRB (911)	294	32.3	Provide next-day availability for checks. <sup>d</sup>
	188	20.6	Disclose use of case-by-case holds in specific availability policy.
	186	20.4	Provide written notice when an exception hold is invoked.
OCC (1,273)	141	11.1	Provide next-day availability for checks. <sup>d</sup>
	138	10.8	Develop procedures and training to ensure compliance with Subpart B of Reg CC.
	120	9.4	Provide written notice when an exception hold is invoked.

<sup>a</sup>To determine the frequency of violations for FRB and OCC we grouped violations by major subsections of Reg CC (e.g., although there are several provisions covered under Subsection 13(g), they all relate to the notice of exception and were grouped together). Violation codes used by FDIC precluded us from making similar groupings of FDIC violations. Therefore, the frequency of violations for FDIC is based on FDIC code designations.

<sup>b</sup>FRB data is for 1/1/89 to 6/30/90.

<sup>c</sup>Percentage of examinations in which the given provision was violated.

<sup>d</sup>The vast majority of these violations involved the provision that requires next-day availability of the first \$100 from the aggregate deposits of certain checks on any one banking day.

# Comments From the Federal Reserve Board

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

July 17, 1991

Mr. Richard L. Fogel  
Assistant Comptroller General  
General Government Division  
United States General Accounting Office  
Washington, D.C. 20548

Dear Mr. Fogel:

The Board is pleased to have this opportunity to comment formally on the draft report of the General Accounting Office (GAO) titled Financial Institutions: Time Limits On Holding Deposits Generally Met But More Oversight Needed, which was prepared by the GAO pursuant to the Expedited Funds Availability Act. The GAO found that the regulatory and administrative framework has been established through which the Act can be effectively implemented. The draft report contains two recommendations, which are designed (1) to facilitate examinations of institutions' compliance with the Act, and (2) to provide guidance to enhance institutions' compliance with the Act.

#### Review of FFIEC Examination Procedures

The report recommends that the five federal banking regulators collectively evaluate their examination experience under the Act and review the FFIEC uniform examination guidelines to identify procedures that they consider essential for assessing compliance with the Act's funds availability requirements. The report states that these procedures should include guidance on (1) the extent of testing of various types of transactions needed to ascertain compliance, and (2) the type and extent of documentation needed to support the examiner's conclusions and facilitate supervisory review. The report recommends that the procedures deemed essential be incorporated into each agency's compliance examination manual and be followed in subsequent examinations.

As noted in the draft report, the Federal Reserve follows all of the FFIEC examination procedures in its examinations of compliance with Regulation CC. We believe that these procedures, when fully utilized, provide examiners with a thorough understanding of a bank's compliance with all applicable provisions of the regulation; therefore, the Federal Reserve

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anticipates that its examinations will continue to rely on the comprehensive FFIEC examination procedures.

The Board understands the GAO's concerns regarding the adequacy of examinations that do not rely on the interagency procedures. We agree that institutions' check holds should be tested to ensure that their practices conform to their policies and comply with the Act's requirements. We also agree that proper documentation of examiners' evidence used in reaching compliance conclusions is necessary for effective supervisory review. The Board welcomes the opportunity to work with the other federal agencies to evaluate ways this recommendation can be implemented in each of the agencies' examination programs.

#### **Supplementary Guidance to Institutions**

The report also recommends that the Board issue supplementary guidance that highlights and illustrates the most frequently violated provisions of the Act, to enhance institutions' compliance with the Act. It is not clear from the draft report whether the GAO is recommending that the Board (1) amend its Commentary to Regulation CC to further clarify those provisions of the regulation that are subject to frequent violations, or (2) send a letter or notice to institutions alerting them to the most frequently violated provisions and providing guidance on how to comply with these requirements. We understand from discussions with GAO staff that the GAO intended to recommend the latter; i.e., that the Board send a letter to institutions providing guidance on frequently violated provisions of the law.

The Board believes that this guidance would be most effective if provided to each depository institution by its primary federal regulator. Therefore, the Board agrees to work with the other federal agencies, under the auspices of the FFIEC, to develop and distribute to depository institutions a notice alerting them to frequently violated provisions of Regulation CC and providing guidance to facilitate compliance with these provisions.

#### **Increased Risk of Check Losses Resulting from Act**

The draft report discusses the increased risk exposure resulting from the Act's funds availability requirements and the Board's legislative recommendations to reduce this risk. The GAO acknowledges that the Act has increased the risk exposure of banks accepting checks for deposit by requiring that the proceeds of the deposits be made available for withdrawal before the bank has had a reasonable opportunity to learn whether the check has been returned unpaid. The GAO appears to conclude that it cannot endorse these legislative recommendations at this time due to a lack of statistical evidence of increased check fraud losses.

See comment 1.

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The report implicitly suggests that only if the banking industry incurs the high administrative costs required to collect and report statistics related to check losses and the statistics indicate that fraud losses are reaching an unacceptably high level should Congress take corrective action.

The Board strongly believes that Congress should address this increased exposure to fraud losses prospectively, rather than waiting until fraud losses mount to an unacceptable level. The impetus for amending the Act's availability requirements should be the risk exposures created by the Act's current requirements rather than statistical evidence documenting the extent to which these exposures have been exploited to date.

To the extent that the Act's current funds availability requirements facilitate even relatively unsophisticated check fraud, they are structurally unsound and should be modified to reduce institutions' risks. For example, the permanent schedule for local checks does not protect institutions from fraudulent activity, since virtually no local check is returned by the second business day following deposit. It is critical that a depositor attempting to defraud an institution not be able to rely on the availability schedules to ensure that funds are available for withdrawal before a fraudulent check is returned.

If amendments to the Act to reduce institutions' risk exposure are not adopted, some consumers could be adversely affected, either because increased fraud losses would be passed through to consumers in the form of higher fees or because banks will attempt to protect themselves from losses by becoming more selective in the customers they serve. Institutions that must make funds available for withdrawal before having a reasonable opportunity to learn whether a check is "good" may rely more on creditworthiness criteria in opening transaction accounts. Such a reaction, although prudent from a safety and soundness perspective, could particularly harm low-income consumers.

The Board has studied whether it is feasible to collect industry-wide data on check losses, given the increased risk resulting from the implementation of the Act. As noted in the draft report, the collection of meaningful data would be difficult. Fraud data prior to the implementation of the Act are only available on an anecdotal basis. Further, in order to determine whether particular requirements of the Act result in high levels of losses to the industry, loss data would need to be collected by:

- (1) the class of check deposited (e.g., government check, official check, local check, or nonlocal check);

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- (2) the availability that had been provided (if a bank that provides immediate availability for deposits incurs a loss, the loss may be attributable to the bank's policy rather than to the Act's requirement); and
- (3) the means of deposit (e.g., at a nonproprietary ATM or over-the-counter).

Few banks account for check losses at this level of detail; therefore, collection of fraud data would represent major accounting changes at banks and a significant additional data gathering effort on the part of the Federal Reserve.

The draft report makes several references to the Board's authority under Section 604(e) of the Act [Prevention of fraud losses]. The Board's authority under this section to suspend the availability schedules could be invoked only after it "determines that depository institutions are experiencing an unacceptable level of losses due to check-related fraud," and that the losses would diminish if the schedules were suspended. The Board questions the value of any remedy that cannot be invoked until the problem reaches "unacceptable" levels.

Moreover, this authority is fraught with practical problems. First, as noted above, obtaining the evidence necessary to suspend the schedules would be difficult, due to the lack of aggregate industry data on fraud losses by type of deposit. Second, if the Board modified the availability requirements pursuant to this section because losses had reached unacceptable levels, institutions would be required by the Act to provide their customers 30 days advance notice of the changes before implementing them. Finally, the Board's modified schedules would remain in effect for only 45 days (which would be about the time that institutions would be able to implement the schedules), unless Congress affirmatively ratified the Board's action. Consequently, institutions would run the risk of providing advance notice of the new availability requirements to their customers, and then not be able to implement the new requirements due to Congressional inaction. This would further increase the banks' costs and would certainly contribute to consumer confusion. Clearly, this statutory authority does not provide an effective mechanism for stemming check losses that may result from the risks inherent in the Act's availability requirements.

The GAO notes in its draft report the operational improvements that have been made to the check return system following the adoption of the Act. These improvements have shortened the return time for many checks, thus decreasing somewhat the risks associated with the Act's availability requirements. The GAO indicates that it did not determine what additional technological or operational improvements could be

- 5 -

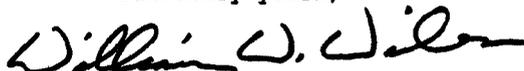
adopted that would further reduce the risks to banks accepting checks for deposit. The Board continues to investigate additional measures that could be taken to speed the collection and return of checks. We do not envision changes that can be adopted in the foreseeable future, however, that would sufficiently reduce the risks inherent in the availability requirements of the Act.

In addition to measures to reduce institutions' risk exposure, the Board has also recommended that Congress adopt several amendments to the Act that would facilitate more cost-effective compliance with the Act's requirements without sacrificing the consumers' protections. Given the significant cost to institutions to comply with this law, we believe that the GAO should endorse suggested modifications to the Act that would lower the costs to comply with its requirements.

While the Board does not believe that the fraud losses stemming from the Act's availability requirements will have a substantial effect on the profitability of the banking industry or pose a significant threat to deposit insurance funds, the Board does believe that in order to ensure that the United States banking system is strong and competitive, banks must be in a position to control their financial risks effectively and must be free of unnecessary regulatory burdens. Accordingly, the Board urges the GAO to reassess the need for statutory amendments to reduce the risks to depository banks created by the Act's availability requirements and recommend that Congress enact such amendments. In addition, we urge the GAO to support other amendments recommended by the Board that would facilitate compliance with the Act.

We appreciate this opportunity to comment on the draft report.

Sincerely yours,



William W. Wiles  
Secretary of the Board

cc: Mark Gillen

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The following are GAO's comments on the Federal Reserve Board's July 17, 1991, letter.

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**GAO Comments**

1. FRB's agreement to work with the other regulators, through FFIEC, should ensure that all depository institutions receive the needed guidance on EFAA provisions.

# Comments From the Federal Deposit Insurance Corporation

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

**FDIC**

Federal Deposit Insurance Corporation  
Washington, DC 20429

Division of Supervision

July 16, 1991

Mr. Richard L. Fogel  
Assistant Comptroller General  
United States General Accounting Office  
Washington, D.C. 20548

Dear Mr. Fogel:

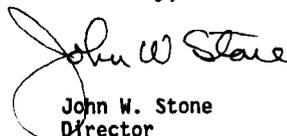
Thank you for the opportunity to review and comment on your draft report on the Expedited Funds Availability Act -- Time Limits on Holding Deposits Generally Met But More Oversight Needed.

The draft report alludes to a number of instances in which agency examiners failed to test check holds placed on deposited funds for conformity to the requirements of the Expedited Funds Availability Act (EFAA) and its implementing Reg CC. The report recommends that the regulatory agencies collectively evaluate their examination experience under the EFAA and review the uniform examination guidelines to identify and implement appropriate examination procedures to adequately assess institutions' check hold practices, including procedures specifying the extent of testing necessary to verify institutions' compliance with the applicable funds availability schedules of the EFAA and Reg CC.

Since the check hold schedules are at the heart of the EFAA, we agree that some testing of check transactions is essential to any credible examination program. Consequently, we fully agree with this recommendation and intend to remind our examiners that test checking is required.

The draft report further recommends that any revised procedures also include guidance on the type and extent of documentation needed to support the examiner's conclusions and facilitate supervisory review. While we recognize that additional documentation can be useful for a variety of purposes, we have traditionally relied on the integrity, judgment and discretion of the individual examiner to perform whatever procedures are directed and appropriate in the circumstances without necessarily documenting all the work performed. We follow this approach in all our examination programs in the interest of saving time and promoting efficiency. Consequently, we cannot support this aspect of the report's recommendation.

Sincerely,



John W. Stone  
Director

See comment 1.

The following are GAO's comments on the Federal Deposit Insurance Corporation's (FDIC) July 16, 1991, letter.

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## GAO Comments

1. We are not advocating that examiners document all of the work they perform; however, we do believe that the examiners should provide evidence in their workpapers to show the basis for the conclusions they reach. In fact, the GAO Statement on Government Auditing Standards, commonly known as the "Yellow Book," requires that a record of auditors' work be maintained in workpapers that contain sufficient information so that supplementary oral explanations are not required.

In the EFAA cases we reviewed in the two FDIC field offices visited, we found numerous instances where an oral explanation was required to understand the basis for the conclusions reached by the examiners. FDIC supervisory personnel in these offices could not provide an oral explanation from their review of the workpapers; instead, they had to contact the examiners who did the work to understand the basis for their conclusions. Presumably, these supervisors would have solicited such oral explanations in cases they selected for quality review when the workpapers were not adequately documented. Consequently, additional time would be needed from both the examiner and the supervisor, which would not serve FDIC's interest in promoting efficiency in its examination process. Further, the other federal regulators responding to the draft report did not question the need for documenting examination conclusions. Thus, we believe FDIC would benefit from working with the other regulators, through FFIEC, to provide examiners with guidance on the type and extent of documentation needed.

# Comments From the Office of the Comptroller of the Currency



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**Comptroller of the Currency  
Administrator of National Banks**

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Washington, D.C. 20219

July 25, 1991

Mr. Richard L. Fogel  
Assistant Comptroller General  
General Government Division  
United States General Accounting Office  
Washington, D.C. 20548

Dear Mr. Fogel:

We have received and reviewed your draft report titled "Expedited Funds Availability Act: Time Limits on Holding Deposits Generally Met But More Oversight Needed." We found the draft to be factually accurate, based on the audit work that was done. The findings are especially useful to the Office of the Comptroller of the Currency as a report on how well the uniform examination procedures are being implemented and how well examination activity is being documented.

The draft report recommends that the Federal Reserve Board and the heads of the other four federal financial institution regulatory agencies collectively evaluate their examination experience under the Expedited Funds Availability Act and review the uniform examination guidelines to identify and implement appropriate examination procedures to adequately assess institutions' check hold practices. Such procedures should specify the extent of testing of check transactions needed to verify institutions' compliance with funds availability provisions and should require documentation to show support for conclusions reached. We find the recommendation to be reasonable and look forward to working with the other agencies to address it with corrective action.

Thank you for the opportunity to comment.

Sincerely,

Jerry Fisher  
Acting Senior Deputy Comptroller for Administration

# Comments From the Office of Thrift Supervision

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



Office of Thrift Supervision  
Department of the Treasury

Timothy Ryan  
Director

1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6280

July 22, 1991

Mr. Richard L. Fogel  
Assistant Comptroller General  
United States General  
Accounting Office  
Washington D.C. 20548

Dear Mr. Fogel:

Thank you for your letter of July 2, 1991, inviting us to review and comment on your draft report on the Expedited Funds Availability Act entitled, "Time Limits on Holding Deposits Generally Met But More Oversight Needed." In general, we agree with the observation that financial institutions subject to the Act are substantively complying with its intent and purpose and that most violations relate to disclosure provisions rather than to deposit holds. Our examination findings support this observation.

We believe, however, that the following draft recommendation warrants specific comment:

**To better administer the Expedited Funds Availability Act, GAO recommends that the Federal Reserve Board and the heads of the other 4 federal financial institution regulatory agencies collectively evaluate their examination experience under the act and review the uniform examination guidelines to identify and implement appropriate examination procedures to adequately assess institutions' check hold practices. Such procedures should specify the extent of testing of check transactions needed to verify institutions' compliance with funds availability provisions and should require documentation to show support for conclusions reached.**

We have conducted separate compliance examinations with trained specialized examiners since April 1989. Prior to that, compliance laws and regulations were reviewed during the regular safety and soundness examination of a savings association. It was the enactment of laws such as the Expedited Funds Availability Act, the sheer volume and sensitivity of the consumer protection laws in general, and our recognition of the need to affirmatively address these matters that contributed to our decision to establish this program.

Appendix VII  
Comments From the Office of  
Thrift Supervision

-2-

Our supervision policy is based upon an association's need to effectively manage its compliance responsibilities. Therefore, our examination approach focuses on the effectiveness of an association's compliance management activities through a review of policies and procedures as opposed to a transaction-by-transaction method. This approach places the responsibility for compliance with laws and regulations directly on management. We strongly encourage savings associations to establish operational compliance programs commensurate with their size and complexity. Moreover, this approach enables us to direct our limited resources to the most sensitive compliance issues.

Consistent with this examination method, the degree of testing of individual transactions is determined by the examiner after a review of management's compliance program and the results of any compliance audits. The number and items tested are different at each association. Ideally, when associations are found to have adequate policies, a reliable, proven, internal means of periodically evaluating the integrity of those policies and adherence to them, and the results of those reviews show substantive compliance, the examiner can limit the amount of testing that needs to be done. Conversely, when severely inadequate policies and poor or nonexistent internal review procedures are encountered, an extraordinary degree of testing is not needed to confirm that the compliance performance level of the association is subpar.

Part of the recommendation asks that OTS work with the other agencies on the Federal Financial Institutions Examination Council (FFIEC) and revisit the current interagency examination procedures for the Act to develop procedures that evaluate actual check hold practices. We agree with that part of your recommendation as it supports our view that examination resources should be directed to areas of greatest risk and sensitivity. It appears to us that the most important element of the law is that depositors receive access to their funds within statutory time frames. As recommended, we will work with the other agencies to review the current procedures.

Another part of your recommendation indicates that the interagency examination procedures should specify the extent of testing of check transactions needed to verify compliance and documentation to support conclusions. Each agency approaches its compliance examination responsibilities differently, consistent with their available resources. As indicated above, we use an examination approach that does not specify, in a numerical fashion, the precise volume of testing. Our method provides the examiner with the flexibility to choose a sample for testing purposes that correlates with a particular association's perceived compliance performance. We believe that the examiner is in the best position to decide how many individual check transactions

see comment 1.

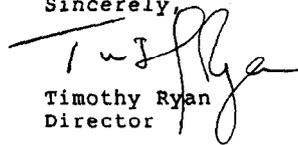
Appendix VII  
Comments From the Office of  
Thrift Supervision

-3-

need to be reviewed at an association to ascertain the effectiveness of management's compliance program and that a preset procedure specifying the extent of testing would be counterproductive to our examination approach. Further, we believe that the issue of documentation for the support of conclusions should be handled separately by each agency and that interagency uniformity in this area would not further the purposes of the Act. We will handle this issue on a unilateral basis.

I trust that these comments are useful in preparing your final report. Should you have any questions, our Specialized Programs unit will be pleased to answer them for you.

Sincerely,



Timothy Ryan  
Director

The following are GAO's comments on the Office of Thrift Supervision's (OTS) July 22, 1991, letter.

## GAO Comments

1. We are pleased that OTS will work with the other federal regulators to review the current FFIEC examination procedures.

In its comments OTS suggests that our recommendation for the regulators to collectively evaluate the FFIEC examination guidelines indicates that those guidelines should specify the extent of testing and documentation required to support examiners' conclusions about EFAA compliance. Our recommendation states that FFIEC procedures should include guidance on the extent of testing and documentation required but does not suggest that the guidance should specify the number of transactions to be tested and documented. Instead, through the regulators' collective experience with the current examination procedures, we believe the regulators can establish uniform examination guidance that serves their individual as well as their collective needs.

For example, OTS' examination approach of reviewing the institution's process for ensuring EFAA compliance is similar to the approach used by OCC. Under this approach or others used by federal regulators, some initial testing of check holds is needed to ensure institutions' policies are, in fact, being practiced. The initial testing may need to be expanded, as suggested by OTS, if noncompliance with stated institution policies and EFAA provisions are identified to determine the extent of such noncompliance and its effect on the institutions' customers. By working collectively and sharing examination experience, the regulators can establish guidance on the testing and documentation needed to satisfy their examination objectives.

# Comments From the National Credit Union Administration



NATIONAL CREDIT UNION ADMINISTRATION

WASHINGTON, D.C. 20456

July 17, 1991

Mr. Richard L. Fogel  
Assistant Comptroller General  
United States General Accounting Office  
Washington, D.C. 20548

Dear Mr. Fogel:

This is in response to your July 2, 1991, letter with enclosed draft report to me. I want to thank you for the opportunity to comment on your report on the Expedited Funds Availability Act -- Time Limits on Holding Deposits Generally Met But More Oversight Needed. We appreciate the professionalism of your staff and the hard work that has gone into developing this document.

We agree or do not object to the recommendations in your report involving credit unions and NCUA. We must state that the immediate implementation of all of these recommendations without proper time, thought, and coordination will overwhelm both credit unions and NCUA. The enclosure contains our comments on your recommendations.

Sincerely,

A handwritten signature in cursive script that reads "Roger W. Jepsen".

Roger W. Jepsen  
Chairman of the Board

EI/WPR:wpr  
Enclosure

Appendix VIII  
Comments From the National Credit  
Union Administration

Now on p. 21.

**COMPLIANCE WITH AVAILABILITY SCHEDULES GENERALLY HIGH BUT IMPROVEMENTS ARE NEEDED IN EXAMINATIONS.**

**Reported Violations of Regulation CC Have Not Resulted in Formal Enforcement Action. (Page 3-2)**

We have not found serious violations of Regulation CC warranting cease and desist action. Our examination procedures instruct the examiner to take reasonable steps to obtain corrective action during the examination. Where minor violations are noted, corrective action must be taken and completed. Ensuing examinations should reflect that proper procedures are in effect. We have addressed minor violations through informal actions. We would take formal enforcement action, including cease and desist orders, if a credit union did not correct the deficiencies noted during the examination.

Footnote 1 on page 3-2 indicates that NCUA could not provide nationwide statistics on Regulation CC violations. Prior to 1991, we did not maintain a database on these violations. Our regional offices are beginning to use a regional database that enables them to record information on violations noted in examinations along with complaints received and their resolution. An agencywide consumer complaint database, currently in the planning stages, will be produced from the regional information.

This regional system was used to respond to the Board of Governors of the Federal Reserve's recent request for information on Regulation CC violations and complaints in the first quarter of 1991.

We have recently updated our examination reporting system. We revised our Examiner's Contact Information (NCUA 2010) to include recording violations of consumer regulations. This will allow us to retrieve information for statistical purposes and follow-up on credit unions with violations of consumer regulations, including Regulation CC.

Now on p. 24.

**Few Consumer Complaints Have Been Reported and Generally Did Not Involve Violations of Regulation CC. (Pages 3-7 & 3-8)**

We agree that financial institutions, particularly credit unions, are generally complying with the Act's funds availability schedule. As we stated in the initial meeting with your auditors, credit unions generally give immediate access to funds deposited in transaction accounts. A phrase most generally associated with credit unions is "We know our members." Credit unions are unique due to their field of membership requirement. Because each credit union's members are associated by means of a specific employer, association, or residential area, rather than

the general populace, many credit unions offer preferred client-type services to their members. The report states that less than 2 percent of all complaints filed with the regulators pertained to this Act. Our regional offices inform us that complaints filed pertaining to the Act usually involve the failure of the complainant to understand the provisions of the Act rather than actual violations of the Act by federal credit unions. Many complaints relate to deposits made to accounts other than transaction accounts and these are usually at credit unions of smaller asset size, usually not offering share drafts or access to automated teller machines. As noted above, our regional offices are establishing a database on complaints received and their resolution.

**FFIEC PROVIDED ADEQUATE EXAMINATION GUIDELINES TO ASSESS COMPLIANCE BUT REGULATORS HAVE NOT UNIFORMLY APPLIED THEM.**

Now on p. 25.

**Use of Examination Procedures Varies. (Page 3-12)**

As you noted on page 3-12 of the report, we have used the Regulation CC checklist on an exception basis due to the number of credit unions that do not have transaction accounts requiring an extensive review. You also noted that we have a limited staff. Completion of the checklist at a credit union where there are no transaction accounts would only add to the amount of examination time expended. We found that the large number of federal credit unions without transaction accounts or the availability of automated teller machines warranted examination procedures that would provide appropriate regulatory review and efficient use of the examiner's time.

We have adopted the FFIEC examination procedures and checklists in our examination program. Our Regulation CC Checklist (NCUA 2058) is completed by the examiner when the initial compliance review indicates that violations may exist, as indicated by a negative answer on the Consumer Compliance Checklist (NCUA 2013). NCUA's guidelines, as contained in our Examiner's Guide, instruct the examiner to determine the degree of compliance with the requirements of the regulation and complete the four questions on the Consumer Compliance Checklist. We use these four questions to provide time management for our examiners in reviewing for regulatory compliance where only regular share accounts (savings) exist.

**EXAMINATION OF CASE FILES YIELDS MIXED RESULTS ON ADEQUACY OF PROCEDURES.**

Now on pp. 27-33.

**Abbreviated Examination Approach at NCUA Was Inadequate for Assessing Compliance. (Pages 3-19 to 3-22)**

The review made by GAO in two of the National Credit Union Administration regions on Regulation CC examination procedures indicated that the examination files were difficult to locate and that those reviewed contained limited information relative to Regulation CC.

**Appendix VIII  
Comments From the National Credit  
Union Administration**

As you noted on page 3-12 of the report, we have used the Regulation CC Checklist on an exception basis due to the large number of credit unions that do not have accounts where an in-depth review is necessary. On page 3-19, you note that the examiner responds to four broad questions and a negative response to one of the questions would require the examiner to complete the checklist for Regulation CC. If the examiner finds areas of noncompliance, an expanded analysis will be completed using the Expedited Funds Availability Checklist, NCUA 2058. The examiner is instructed to take reasonable steps to obtain corrective action during each examination. Depending on the seriousness of noncompliance, the corrective plans should be documented in the Record of Action section of the examination report.

We note your comments regarding the four questions we use on our Consumer Compliance Checklist (NCUA 2013). Our examiners, following NCUA guidelines, review all practices and policies regarding funds availability in order to answer the four questions. We will be reviewing the questions to ensure that they achieve the examination objectives of determining that all of a credit union's funds availability policies are in compliance with Regulation CC, as set forth by the Federal Financial Institutions Examination Council.

We will be restating to our examiners, through our regional offices, that all of a credit union's funds availability policies and practices, not only those for local and non-local checks, will be reviewed for compliance with Regulation CC. Sampling documentation supporting the conclusions reached by the examiner in the review of check holds will be included in the examination report.

**GAO RECOMMENDATIONS (Page 3-26)**

We agree that the financial institution regulatory agencies collectively evaluate their examination experience and implement essential examination procedures to adequately assess check hold practices. As noted previously, we will be restating to our examiners that testing of check holds is required and that the examination scope and report should include documentation on the testing of various transactions supporting the conclusions reached. The type and extent of documentation needed for conclusions and supervisory review can be formalized in examination procedures developed among the regulatory agencies.

We also agree with your recommendation that the Federal Reserve Board issue additional clarification needed to assist financial institutions in understanding and complying with the more complex provisions of Regulation CC. Our examiners instruct credit union officials on the regulation and inform them that training for employees is required to ensure compliance with the regulations. Confusion as to the requirements of the regulation by credit union officials and employees along with inadequate training are considered to be the principal causes for any violations of the regulation.

Now on pp. 34-35.

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