Good Funds Industry FAQs

My current state good funds law requires funds to be "finally settled." What does that mean and why does the Model not impose this requirement?

The term "finally settled" as used in many states' good-funds laws is somewhat unclear because the concept of "final settlement" varies between payment rails and their underlying bodies of law. Existing state good-funds laws that require "finally settled" funds are probably intended to mean that any provisional credit given to the receiving account holder has become final, even if technically the term "final settlement" might refer to a different step in the payment process depending on the payment rail and the body of laws or rules being referenced. These laws appear to set a high standard that will reduce most (but not necessarily *all*) of the risks associated with a reversal of payment. In practice, however, it may prove difficult to determine whether that standard has been met. Existing state good-funds laws that require "collected" or "unconditional" funds as a condition precedent to disbursement may be similarly difficult to interpret and administer. The Model avoids these difficulties by relying on easily and objectively verifiable criteria for determining whether funds received into escrow are "good funds."

What does it mean for funds to be "at least equal to the amounts to be disbursed"?

The second condition to disbursement in Section 3(b) is that the funds deposited into the escrow account must be in an amount at least equal to the amounts to be disbursed for the transaction. In most cases, this will entail the receipt of all necessary funds for a transaction into escrow before making all disbursements at the time of closing. These receipts and disbursements would be reflected on a final, signed, and dated settlement statement directing the disbursements to be made for the transaction.

It is possible for there to be more funds in the account than are proposed to be disbursed, such as if a party to a transaction intentionally "overfunds" the escrow to cover any potential last-minute adjustments to a settlement statement. In this case, the party who overfunded would likely be entitled to a return of the excess. Such overfunding would not preclude disbursement of all other funds for a transaction from an escrow account.

However, in some cases the parties may wish to authorize a partial disbursement of funds received for a limited purpose prior to closing. For example, the parties may wish to use a portion of an earnest money deposit to obtain an estoppel certificate from a common interest community or to record a document in the land records prior to closing, with the disbursement to be appropriately reflected on the settlement statement. Section 3(b) does not preclude such an authorized disbursement from escrow, provided the other requirements of Section 3 are satisfied (that is, funds have been credited to the account as "good funds" available for use or withdrawal).

What does it mean for funds to be "available for immediate use or withdrawal"?

The fourth condition to disbursement, found in Section 3(d), is that the funds deposited into the escrow account must be available for immediate use or withdrawal from the account. Having available funds is a threshold requirement for making sure the escrow agent does not overdraw its account or disburse funds that properly belong to its other customers or clients. Funds availability is not only a minimum requirement imposed by banks for permitting the immediate disbursement from an account, but it is also an easily and objectively verifiable standard.

When deposits or other credits are received by a bank, it will typically post them to one of several book entries associated with the account. An account's "ledger balance" typically reflects the opening and closing position of an account and includes all deposits and withdrawals made over the course of a banking day, but it will not reflect any intraday activity or necessarily represent what funds are currently available for use. An account's "available balance," by contrast, will typically indicate all credits and debits posted to the account during that banking day, thereby representing the net amount the bank considers available for immediate use or withdrawal under the terms of its deposit account agreement or as required by law. Transactions that the bank does not consider as having fully posted to the account as available funds, such as pending credits or debits, check holds, and the like, are excluded from the "available balance" and usually indicated as such by the bank.

The timing of funds availability is governed by both state and federal law and subject to the terms of the deposit contract. Applicable law includes UCC Article 4 (for checks, *e.g.*, UCC § 4–415(e), (f)) and Article 4A (for funds transfers), the federal Expedited Funds Availability Act, 12 U.S.C. §§ 4001 *et seq.*, and its implementing regulations known as Regulation CC, 12 C.F.R. Part 229 (for checks, wire transfers, and ACH credit transfers). The details of these laws and their interaction are rather complex. Minimum timing requirements can range from next-day availability (*e.g.*, for deposits of cash, wire transfers, or cashier's checks meeting certain in-person deposit requirements) to second business-day availability or even a longer "reasonable" time (*e.g.*, up to five business days for large check deposits exceeding $5,525 on any one banking day).

It is important to emphasize, however, that funds availability does *not* mean that there is no risk of reversal of the payment. While certain payment rails result relatively quickly in "receiver finality"—the irrevocable obligation of a debtor bank to pay its creditor account holder under the terms of the deposit contract—other payment methods carry risks of possible reversal that can extend from days to even months or years depending on the defect in the payment. Funds availability is therefore a minimum requirement. It does not, by itself, mean that the funds deposited or credited into an account are irrevocably available to the account holder.

What type of bank account would be an "escrow account" subject to the Model?
An "escrow account" is broadly defined under this Model in Section 2(d). Any bank deposit account satisfying the basic criteria of the definition will be subject to this Model. First, the account must be established at a "bank" as broadly defined in Section 2(a). *Compare* UCC § 1–201(b)(4) and § 4–105(1). Second, the account must be a *demand deposit account* as that term is generally understood. Such an account is one from which available deposited funds can be withdrawn at any time by the depositor with no or little prior notice or penalty. The typical checking account falls within this definition, but excluded are *time deposit accounts* in which funds are deposited for a specified period of time, such as certificates of deposit (CDs). Finally, the account must be segregated, containing only customer or client funds, not commingled with the escrow agent's own funds. The account might be titled an "escrow account" or a "trust account" to indicate its status. Such words in the account title might be sufficient or necessary under state law to insulate customer or client funds held in the account from any rights of bank setoff, garnishment, or other creditor process.

Other policy questions about what types of demand deposit accounts are appropriate for use by escrow agent is left to other law. For example, whether a negotiable order of withdrawal (NOW) account, which is essentially an interest-bearing checking account, is acceptable for use by an escrow agent is not decided in this Model. States permitting such accounts usually also regulate who may be entitled to any earned interest. For example, today every state permits lawyers to use interest-bearing trust accounts to raise money for charitable purposes; these are known as Interest on Lawyers' Trust Accounts (IOLTA). *See also* 12 C.F.R. § 204.130. By contrast, interest-bearing corporate "sweep" accounts are technically mutual funds and not deposit accounts and so do not fit the definition of "escrow account" in this Model.

Whether money market accounts are classified as demand deposit accounts is unlikely, although the answer may vary between depository banks. A money market account classified as a demand deposit account would be subject to this Model if used by an escrow agent for disbursements in a real estate transaction. These accounts are mostly used in real estate transactions to invest short-term funds such as earnest money deposits. They are usually closed with principal and accrued interest transferred to the escrow agent's general escrow account at settlement. Money market accounts are usually unsuitable for use as a general escrow account, however, because of limits on the allowable number of transactions (typically six per month). Although Regulation D was amended to lift such limits in 2020, most banks still impose them.

The Model permits "United States currency" as "good funds," but doesn't payment in cash for a real estate transaction carry risks?

Yes. Like all methods of payment, the use of currency in a real estate closing is not completely risk free. The term "United States currency" refers to physical Federal Reserve notes and coins minted by the United States. Currency may be considered the best form of "good funds" in terms of payment finality. That's because the physical delivery of currency results in immediate and final payment. If exchanged in good faith and for consideration, the delivery and acceptance of currency passes title to the money free and clear of any competing claims.

However, handling and transporting any amount of currency carries risks that escrow agents should carefully balance before accepting, from security concerns to the risk of counterfeit money. Moreover, handling large amounts of currency can impose additional obligations on escrow agents. If a business receives more than $10,000 in currency in a single transaction or in related transactions it must report the payment on IRS Form 8300, either electronically or on paper. Filing may also be required for a payment in currency of less than $10,000 if another payment is also made by cashier's check or bank draft with a face value of $10,000 or less and the combined payments are being structured to avoid reporting requirements. For more information and links to further resources, *see* https://www.irs.gov/businesses/small-businesses-self-employed/form-8300-and-reporting-cash-payments-of-over-10000.

What is a "wire transfer"? Does that term in the Model mean the same thing as it is used in my state's current good funds law?

The term "wire transfer" is used in the existing good-funds statutes of several states without further elaboration. As such, the term may carry an unintended degree of ambiguity, particularly as to whether a "real-time" or "instant" payment qualifies as a "wire transfer." This Model avoids any ambiguity by precisely defining what forms of payment constitute a payment by "wire transfer"—Fedwire® and CHIPS® payments—and clearly distinguishing those payment methods from modern "real-time" or "instant" payment rails.

What types of payments are covered by a same-bank "debit entry" and "credit entry"?
Section 2(f)(v) describes what is sometimes referred to as an intrabank "book transfer." Often such a book transfer may be considered a "wire transfer," but technically it could be achieved through various intrabank processes. A book transfer is typically initiated by a "payment order" submitted to the same bank at which the escrow agent holds its escrow account. Such a payment may be initiated and processed electronically and result in final payment to the escrow agent's account. However, because it is not an interbank payment it necessarily will not be made via a funds-transfer system like Fedwire® or CHIPS®. Instead, the bank will merely post corresponding debit and credit entries to the accounts of its two customers as payor and payee. If initiated by a non-consumer, such a payment order is subject to Article 4A and results in the same receiver finality as any other wire transfer. *See* Section 4A–104, cmt. 1, *Case #1* (describing a one-payment-order funds transfer referred to as a "book transfer" and governed by Article 4A).

Expressly excluded from this provision are same-bank debit/credit entries made "by check." Checks that are drawn by a payor on the same bank where the payee deposits the check for collection are often referred to as "on-us" checks. These checks are separately addressed in Section 2(f)(vii)(B).

Why do some checks, like cashier's checks, seem like they are considered "better" funds than others?
The list of checks in Section 2(f)(vi) represents those checks that, if authentic and authorized (not forged, counterfeit, altered, etc.) represent a close equivalent to cash. Cashier's checks, certified checks, and teller's checks, for example, are understood to be a close cash equivalent such that delivery and acceptance constitutes immediate payment and discharge of any underlying obligation, even though the check itself (which becomes the only remaining enforceable obligation) has not cleared through the collection process. UCC § 3–310(a). These instruments are considered near-cash equivalents because they are backed by the general credit of the payor bank itself, not merely the credit of an individual account holder; being signed or countersigned by the issuing bank, the bank is obliged to pay. UCC §§ 3–401(a), 3–412.

Similarly, checks issued by the U.S. Treasury or by a state or local government are backed by the creditworthiness of the issuing government and ultimately the taxpaying public. (Excluded from the list of drafts in Section 2(f)(vi) but included in Regulation CC are U.S. Postal Service money orders, which are not routinely used in real estate transactions.)

Not coincidentally, these items typically result in faster available funds to the depositor. They are accorded next-day funds availability under Regulation CC, 12 C.F.R. § 229.10(c), if deposited over the counter. (Note that “large deposits” to the extent they exceed $5,525 may still be subject to a “reasonable period” of delay in funds availability. *Id.* § 229.13(b), (h).) Even so, as noted above, funds availability does not mean there is zero risk of a future problem that results in a charge-back to the escrow account. This is true even of cashier’s checks and related check types.

What about any checks that are not on the “better” funds list? What makes them riskier and less likely to be “good funds”?

Other checks are subject to greater chances of reversal of provisional credit given to the depositor. This is primarily because they are subject to the creditworthiness of the drawer of the check. That is to say, there may not be sufficient funds in the drawer’s account to cover the check, resulting in a dishonor by the payor bank.

In addition, unlike a cashier’s or other bank check, private party checks may be subject to a stop payment order. They may also be subject to a greater risk of being unauthorized. For example, checks issued by a corporate entity may require multiple signatures to be enforceable. UCC § 3–403(b). If not properly authorized by all required signatories, the check is not properly payable and thus not chargeable against the payor entity. UCC § 4–401(a). A forged check may not be noticed by the authorized account holder until it sees the charge on its monthly bank statement.

This is just a small list of some of the more common problems that can affect the collectability of private party checks.

Are checks drawn on a foreign bank acceptable under the Model?

No. Checks drawn on a foreign bank could be subject to extraordinary risks of non-collection that make them likely to be inappropriate in any U.S. real estate transaction. The only checks acceptable under Section 2(f)(vii) are those “drawn on a bank.” A “bank” is defined in Section 2(a) as excluding any bank “not subject to regulation as a bank under federal law or law of a state, district or territory of the United States.” This definition of “bank” therefore effectively excludes acceptance of any check drawn by a private party on a foreign bank.

Instead, in real estate transactions involving foreign parties sending funds from overseas or outside the United States, the parties should send such funds into escrow via a wire transfer. For example, the payment order may be originated in a foreign country via the SWIFT messaging system, which is a system that sends payment orders to intermediary banks for international payments. The actual funds transfer would then likely take place via either Fedwire® or CHIPS® as the funds transfer system.

If I wait at least six banking days after depositing a check, is it guaranteed to be "good funds" that I can disburse?

Not necessarily. The six-banking-day rule suggested in this Model is a prudential one rather than a hard-and-fast legal rule, although the choice of this timeframe has a sound basis in the law. **Some states may choose to insert a longer time period in the bracketed text.** Most of the major problems associated with collecting payment on a check should arise within this window or, if discovered later, do not typically result in a charge-back to the depositor. Other problems, however, may only be revealed months or even years later and can still result in a reversal of the payment or charge-back against the depositor's account.

Some major problems usually result in the payor bank being responsible for the loss after it makes final payment. These problems include fraud, forgeries, counterfeit checks, stop payment orders, and insufficient funds. However, some depositary banks continue to place the risk of loss for a forged or counterfeit check on their customers for several months or longer. For example, banks that participate in the ECCHO check collection system and have not opted out of "ECCHO Rule 9" effectively place these risks on payees who deposit checks. (*See further* at https://www.theclearinghouse.org/ECCHO/ECCHO-Rule-9.) Problems that can fall on the payee even after this time include any alterations made to a check and the lack of a required indorsement. And even if the payor bank should normally be responsible for the risk of loss, it can sometimes shift this liability back onto the payee (for example, because of the payee's own wrongdoing or negligence).

Note that some states currently impose a *ten-calendar-day* rule for deposited private-party checks. *See* KAN. STAT. ANN. § 40-1137(c)(5); MO. REV. STAT. § 381.412(2)(1); S.C. Rules of Professional Conduct § 1.15(f)(2)(vi). A "banking day" in Section 2(b) is defined similarly to the UCC Article 4 definition of this term and means any day in which a bank is open to the public for substantially all operations. *Compare* UCC § 4–104(a)(3). It may or may not include a weekend day but will exclude any federal bank holidays. Six banking days could thus extend from seven to nine calendar days. States may choose to adopt a longer timeframe than the sixth day after deposit, as is indicated by the brackets.

If I wait at least two banking days after depositing an "on-us" check, is it guaranteed to be "good funds" that I can disburse?
Not necessarily. The risks described above may apply equally to an "on-us" check. The two-banking-day rule suggested in this Model is a prudential one rather than a hard-and-fast legal rule, although the choice of this timeframe has a sound basis in the law. **Some states may choose to insert a longer time period in the bracketed text.**

An "on-us" check is one drawn on the same bank used by the depositor. In other words, it is a check where the depositary bank and the payor bank are the same. Similar rules governing final payment and final settlement apply to "on-us" checks as to other kinds of checks. UCC §§ 4–301(b), 4–302(a)(1). Because of the fewer steps required in the check collection process, both federal and state law provide for faster funds availability for "on-us" checks. *See* Regulation CC, 12 CFR § 229.10(c)(1)(vi) (next-day availability); UCC § 4–215(e)(2) (second-day availability for withdrawal "as of right," expressly subject to other "applicable law"). However, as explained above, for a number of reasons funds availability does not mean that credit given for a deposit might not be later reversed.

What does it mean for a check to be "properly payable"?
Several state good-funds laws provide a list of private party checks that may be presumed to be reliably drawn and backed by sufficient funds. Examples include checks drawn on lawyer trust accounts, real estate broker escrow checks, insurance company checks, and the like. Under the good-funds laws of these states, such checks are treated as roughly as reliable as cashier's checks and other bank checks, but usually subject to a maximum dollar amount. The general principle embodied in these existing laws is that the escrow agent has some reasonable and prudent grounds—for example based on other laws regulating the drawer of the check—to believe that the check will be collected and finally settled. Indeed, some good-funds laws explicitly refer to this general principle as well. *See*, *e.g.*, 215 ILL. COMP. STAT. § 155/26 (maximum $50,000); N.C. GEN. STAT. § 45A-4(a)(4)–(6) (maximum $5,000 for personal or commercial checks); UTAH CODE § 31A-23a-406 (7)(b)(iii)(B), (D) (maximum $10,000.)

This Model adopts a similar approach. Under Section 2(f)(vii)(A) "good funds" includes any check up to a specified maximum amount that the escrow agent has reasonable grounds to believe is "properly payable." Such reasonable grounds may exist where, for example, the check is drawn on a licensed lawyer's or real estate broker's trust account. The bracketed amount of $5,000 is merely recommended. **Some states may choose to insert a smaller or larger dollar amount in the bracketed text.**

Under UCC Article 4 a check is "properly payable" if "it is authorized by the customer and is in accordance with any agreement between the customer and bank." UCC § 4–401(a). This definition may seem rather abstract, but it has a settled meaning. A check that is properly payable may be charged to a customer's account without liability falling on the payor bank, and therefore it excludes those provisions under UCC Articles 3 and 4 that make the check unenforceable against the account holder or require mandatory dishonor by the bank. Indeed, if a bank refuses to pay a "properly payable" check it may be liable for wrongful dishonor under UCC § 4–402(a). For example:

- An authorized check is one signed by the true account holder. It is thus not a forgery or counterfeit. If an organization is the drawer of the check, it is not missing a required signature. UCC §§ 3–401 to 3–403.

- There are no forged or missing indorsements to the check. Such a check may still represent a valid order for payment, but the missing authentic indorsement could mean that there is no "person entitled to enforce" the check because it is payable to someone not in possession. *See* UCC § 4–401, cmt. 1 ("An item containing a forged drawer's signature or forged indorsement is not properly payable.").

- The customer must not have put a stop payment order on the check at the time the payor bank charges it against its customer's account. UCC § 4–403(a).

- The payor bank must not have received legal process and been given a reasonable time to act on it before final payment. UCC § 4–303.

- The drawer of the check must not have died or been adjudicated incompetent with the payor bank having knowledge of that fact. UCC § 4–405.

- A check that has been altered (for example, by changing the payee's name or amount to be paid) is only properly payable as it was originally written before the alteration was made. UCC § 3–407(b), (c).

- The check must not create an overdraft (unless the payor bank *chooses* to overdraw the account, for example because of an overdraft agreement). UCC § 4–401(a).

- Finally, a post-dated check is only properly payable on its date. UCC §§ 3–113(a), 3–108) However, a bank may treat as post-dated check as properly payable unless its customer gives it prior notice of the post-dating. UCC § 4–401(c).

For more details on the concept of a "properly payable" check, *see* FREDERICK H. MILLER & ALVIN C. HARRELL, THE LAW OF MODERN PAYMENT SYSTEMS § 9.1[3] (2d ed. 2017); MICHAEL D. FLOYD, MASTERING

NEGOTIABLE INSTRUMENTS (UCC ARTICLES 3 AND 4) AND OTHER PAYMENT SYSTEMS, at 126–129, 161–166 (2d ed. 2018).

To sum up, an authentic, unaltered, and non-post-dated check with all required signatures will be "properly payable" if there are sufficient funds in the payor's account, the payor is competent, there is no legal process against the account, and the payor does not put a stop payment order on the check. An escrow agent may have reasonable grounds to believe a check is properly payable because of the regulated status of the payor (such as a licensed lawyer, broker, insurance company, other escrow agent, etc.) or because of other facts and circumstances, such as sufficient past dealings with the payor demonstrating the check signer's authority, the check's authenticity, and the payor's reliability.