

Depository Bank RDC Risk: The RDC Indemnity and Holder in Due Course

ECCHO®

DISCLAIMER

The information contained herein has been prepared for general informational purposes only and is not offered as and does not constitute legal advice or legal opinions. You should not act or rely on any information contained herein without first seeking the advice of your legal counsel. The appropriate course in the event of a disputed check transaction, and liability for such transaction, may depend on the facts and circumstances.



BOFD Warranties

UCC warranties 3-417, 4-208

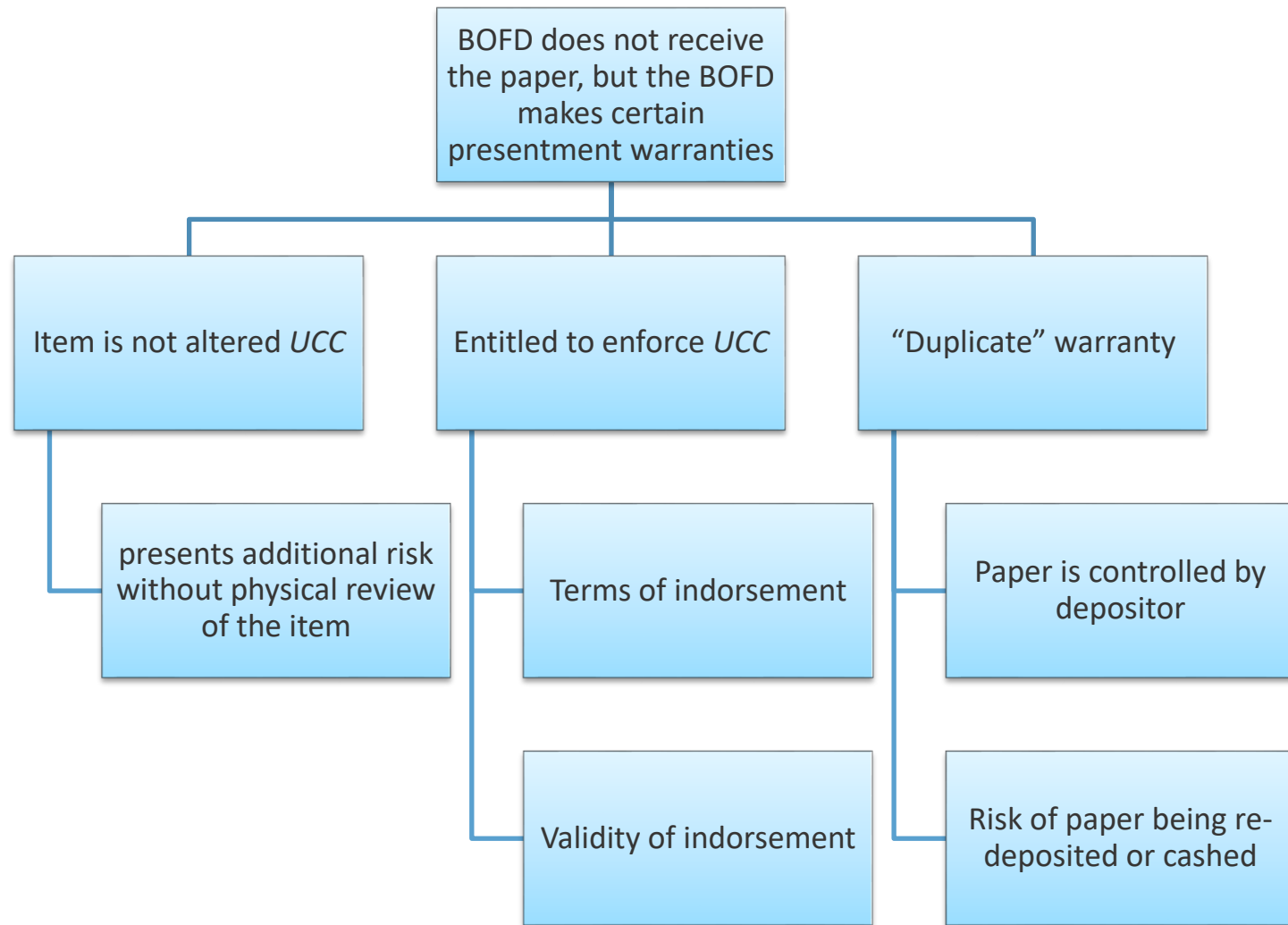
- “entitled to enforce”
- The draft has not been altered
- No knowledge that the signature of the drawer is unauthorized

Regulation CC §229.34(a)(ii): no “double debit” warranty

- *No person will receive a transfer, presentment, or return of, or otherwise be charged for an electronic check or electronic returned check, the original check, a substitute check, or a paper or electronic representation of a substitute check such that the person will be asked to make payment based on a check it has already paid.*



RDC BOFD Risk




BOFD Warranty Risks

BOFD “duplicate check” warranty



BOFD warrants it is “entitled to enforce”



BOFD risks warranty/indemnity claim if another bank received the paper and suffered a loss due to return/adjustment of item



RDC Indemnity (229.34(f))

Purpose of Indemnity:

- To protect subsequent depository bank that received deposit of paper check from loss when check is returned unpaid due to duplicate RDC item
- To encourage RDC banks to implement good RDC deposit practices

Addresses Risk:

Customer retains original check and may intentionally or mistakenly deposit paper check in another bank

RDC bank's potential liability rises when it permits customer to truncate check and deposit image



RDC Indemnity Rule Text (229.34(f))

(1) The indemnity described in paragraph (f)(2) of this section is provided by a depository bank that—

(i) Is a truncating bank under § 229.2(eee)(2) because it accepts deposit of an electronic image or other electronic information related to an original check;

(ii) Does not receive the original check;

(iii) Receives settlement or other consideration for an electronic check or substitute check related to the original check; and

(iv) Does not receive a return of the check unpaid.

(2) A bank described in paragraph (f)(1) of this section shall indemnify, as set forth in §229.34(i), a depository bank that accepts the original check for deposit **for losses incurred by that depository bank** if the loss is due to the check having already been paid.

(3) A depository bank may not make an indemnity claim under paragraph (f)(2) of this section if the original check it accepted for deposit bore a restrictive indorsement inconsistent with the means of deposit.



Indorsements UCC 3-205, 206

Blank

- Payee indorses with name only
 - Becomes a bearer instrument

Special

- Indorsement identifies a person to whom the check is payable
 - Indorsed by payee, made payable to another person

Anomalous

- Indorsed by person who is not the named payee

Restrictive

- Indorsement limiting payment to particular condition
 - “for deposit only”



RDC Indemnity: BOFD Terms to Receive the Indemnity

Depository bank must receive the original check for deposit

- Indemnified depository bank does not have to send the original check for payment; can send image or IRD to paying bank

Restrictive indorsement may negate indemnity

- If depository bank accepted for deposit an item contrary to terms of the indorsement

Depository bank must suffer a loss due to a chargeback due to the check having already been paid

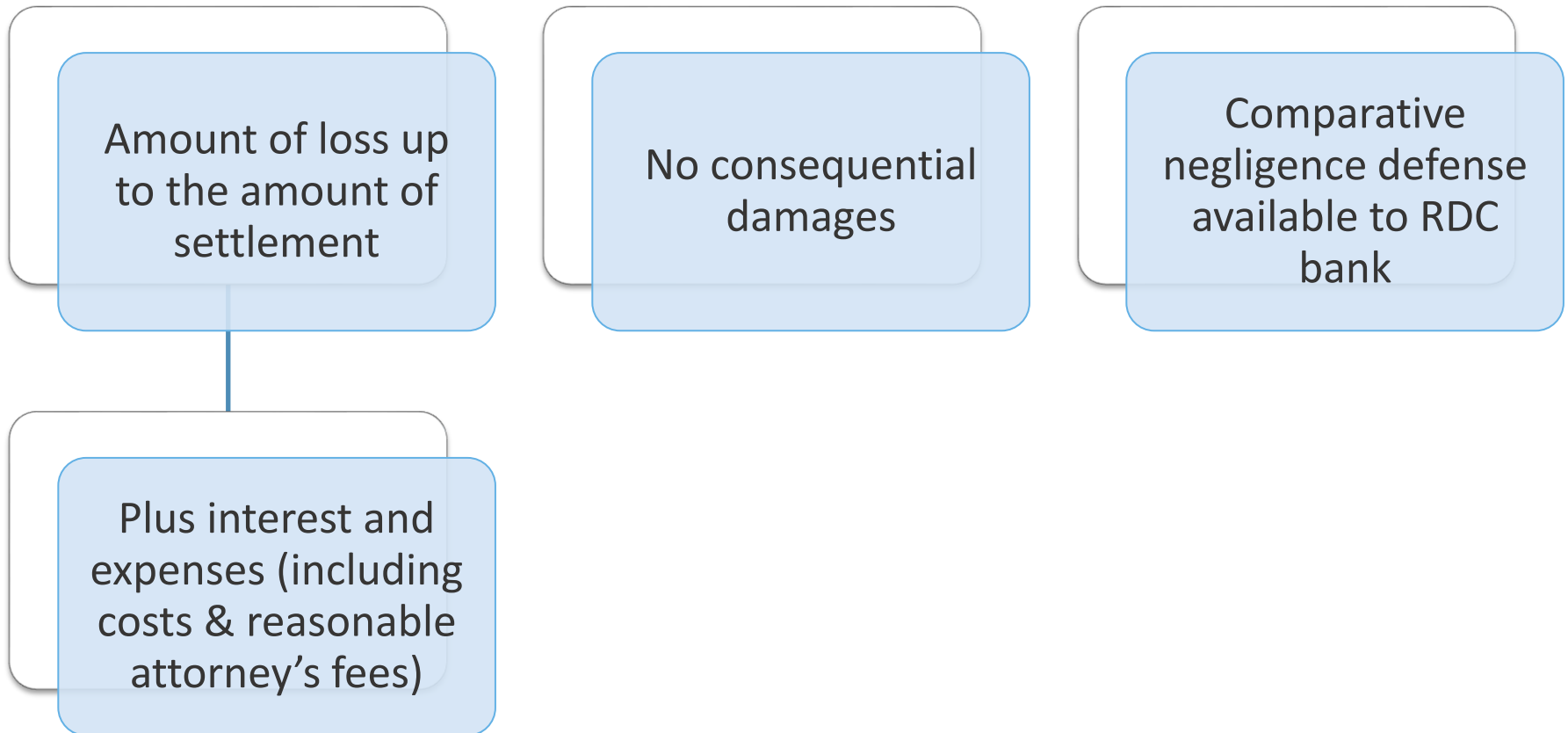
Does not indemnify customer

- RDC bank can allocate loss per customer agreement

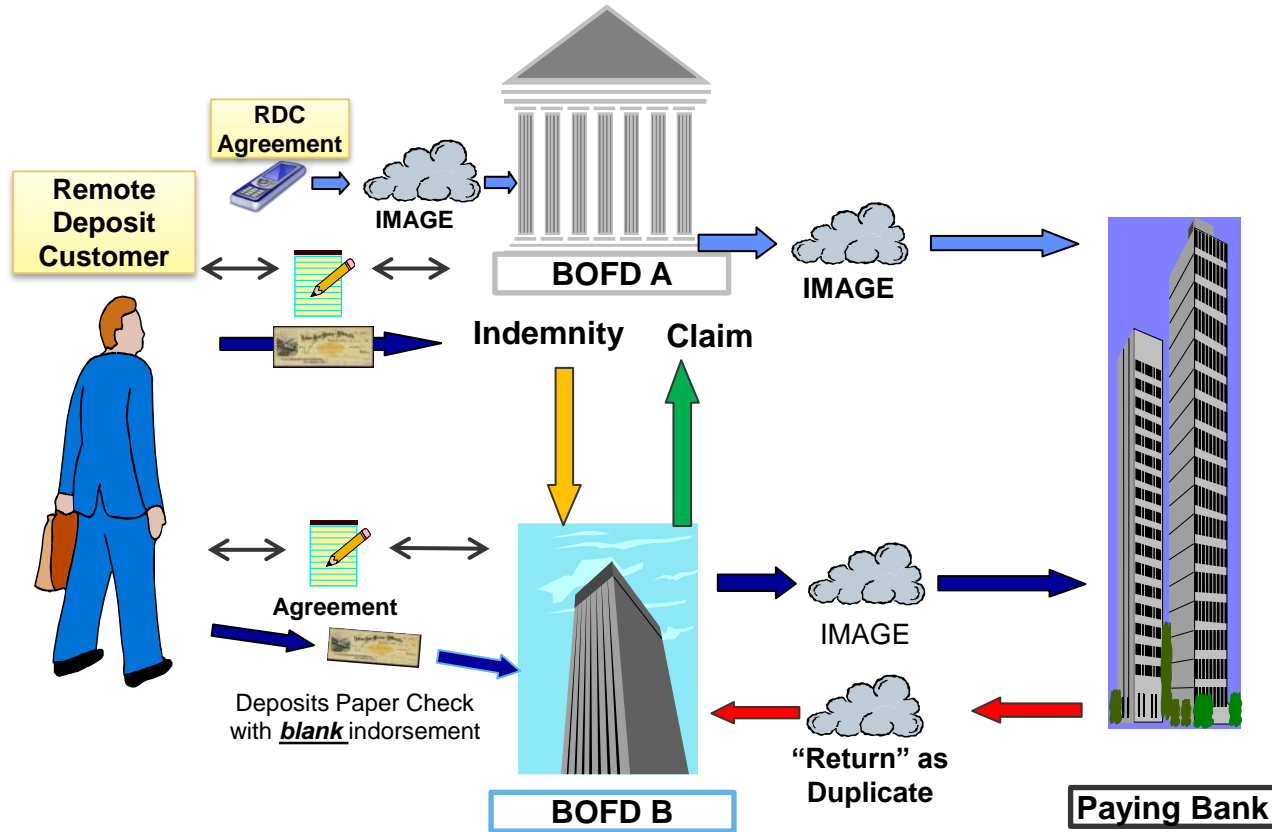
Does not indemnify other banks in the collection process



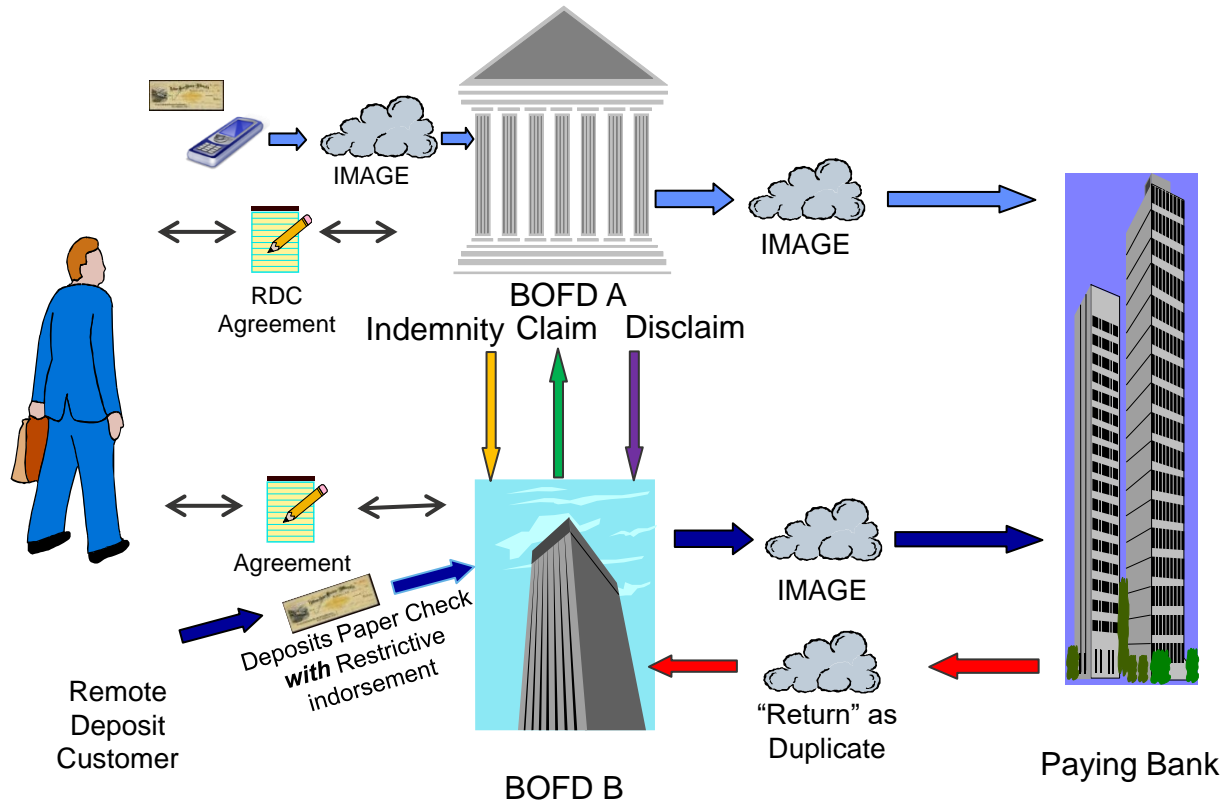
RDC Indemnity: Amount of Liability



RDC Indemnity Claim



RDC Indemnity: Restrictive Indorsement Disclaim



RDC BOFD Risk Considerations

UCC warranties

- “entitled to enforce”
 - Properly indorsed
- Not altered

Regulation CC warranties & indemnities

- No “double debit”
- RDC indemnity
- ECI indemnity



RDC Deposit Agreement Considerations

Add RDC indemnity language

- Consider addressing RDC customer's liability for duplicate negotiation of the RDC deposited item

Consider addressing a restrictive indorsement requirement

- “for *mobile deposit* to XYZ Bank”

Consider restricting certain types of checks from remote deposit

- US Treasury, US Postal Money Orders, etc.



RDC Considerations

Review customer qualifications for RDC deposit

- Length of relationship
- History of account activity
- Credit history, etc.

Consider enforcing restrictive indorsement

- *i.e. “for mobile deposit only to XYZ Bank”*

Establish controls to review submitted RDC items

- Indorsement review

Establish daily/weekly deposit limits

- Item limit
- Deposit limit



Holder in Due Course: *UCC 3-302*

Person that accepted the ***paper*** check

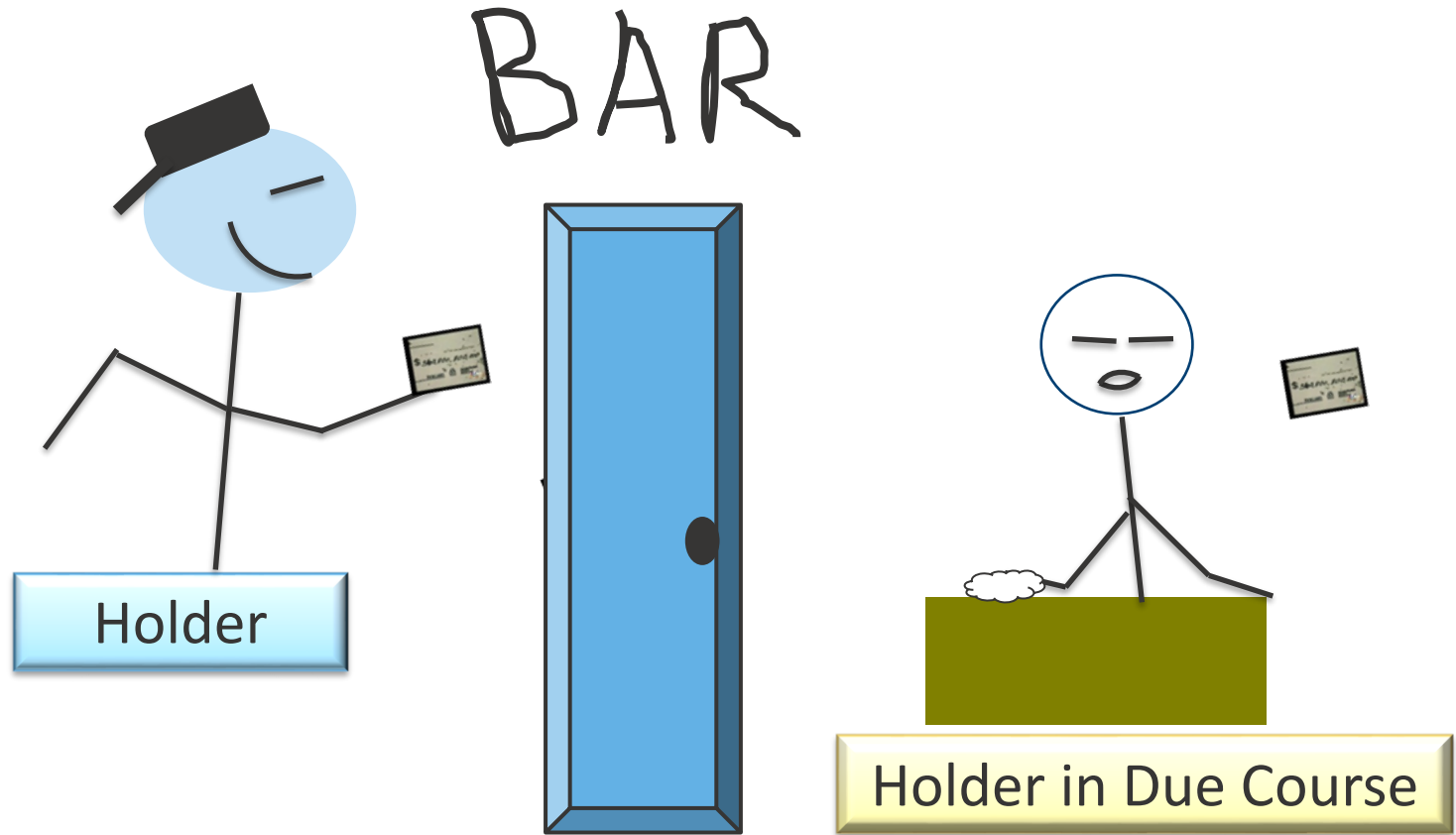
- For value
- In good faith
- Without notice that the check is overdue or has been dishonored
- Without notice that the check contains an unauthorized signature *or* has been altered
- Without notice of any claim to the check or that any party has a defense or claim

May enforce the check against the drawer

- May result in the drawer paying the same check twice



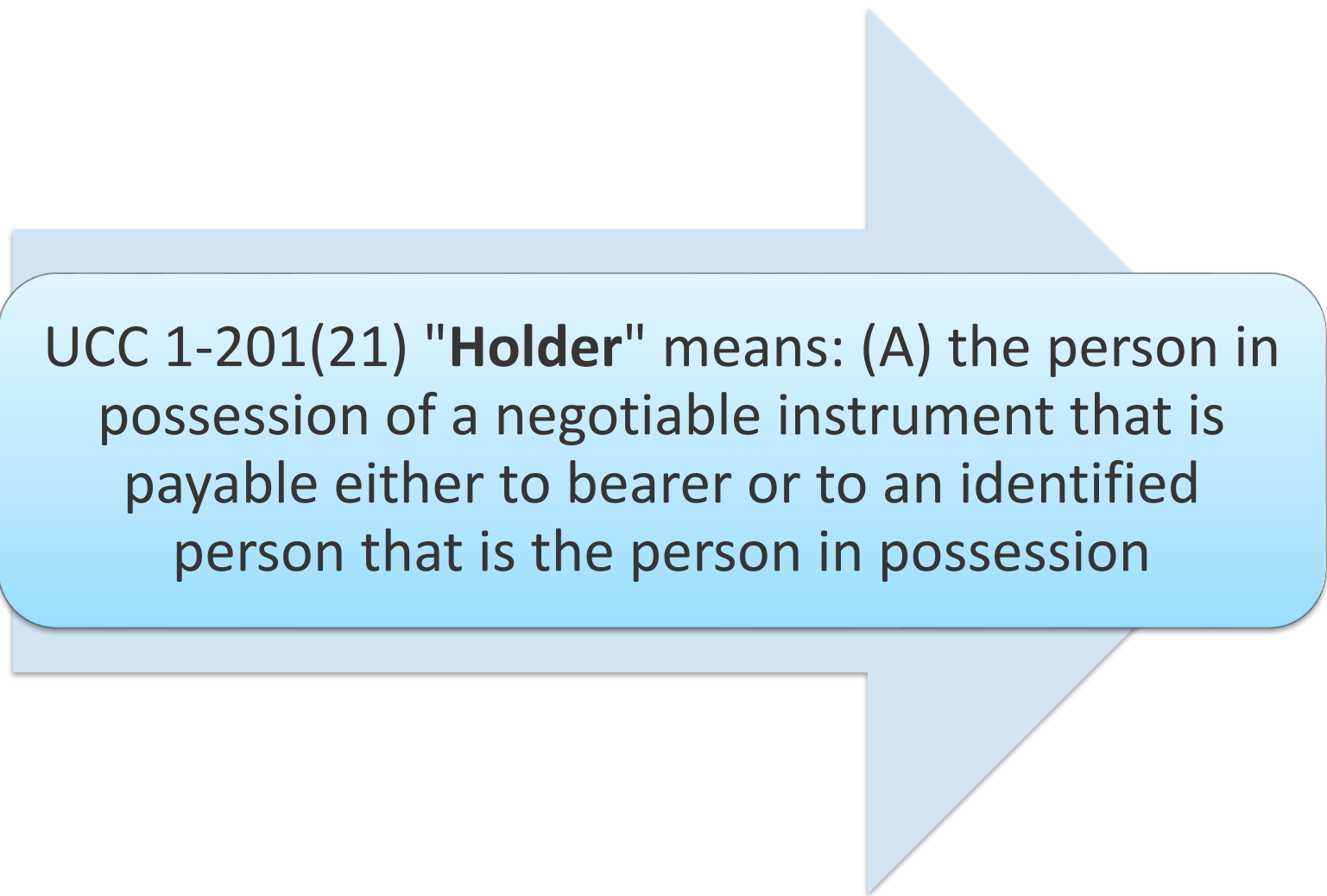
A guy walks into a bar . . .



. . . and cashes a check



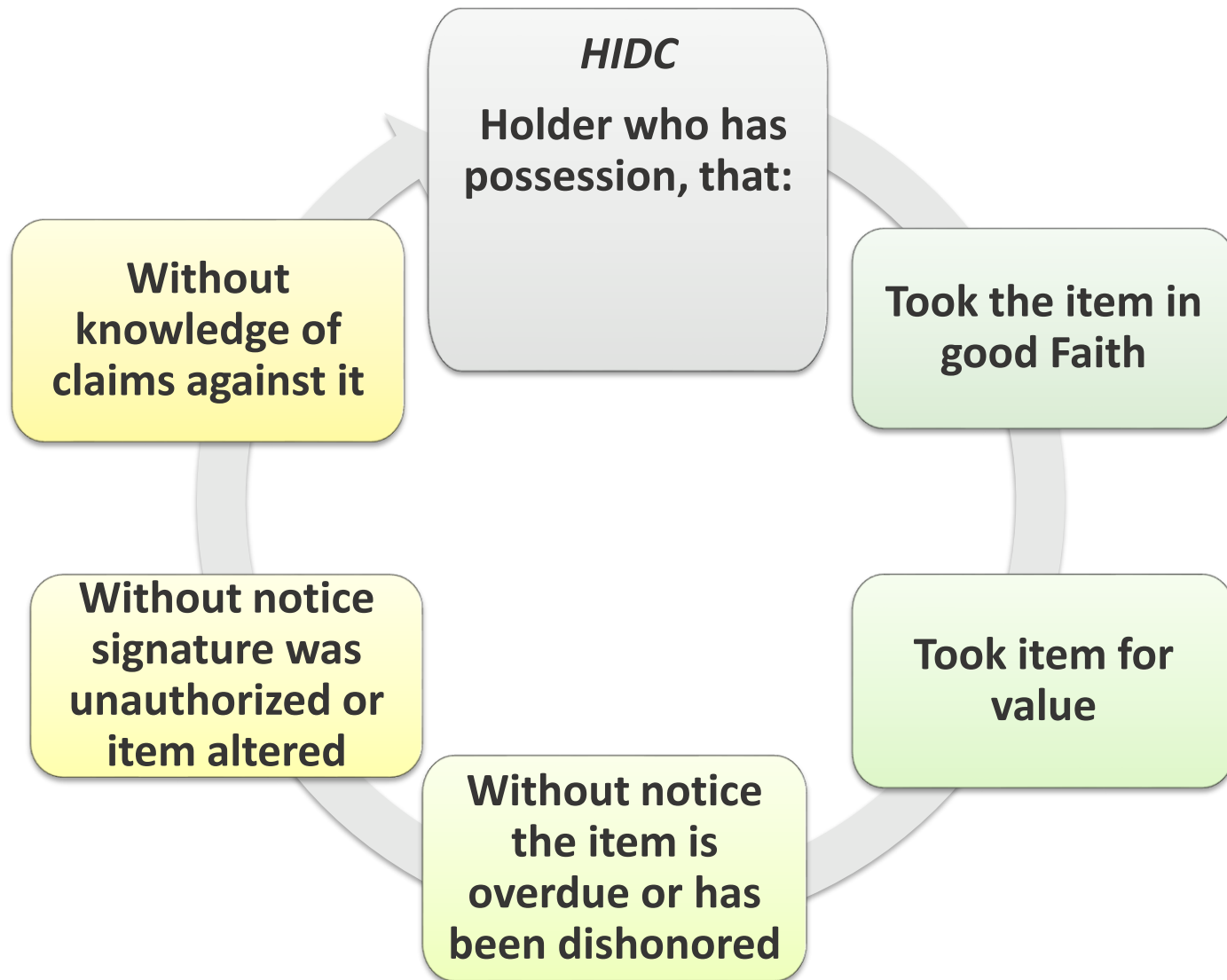
Holder



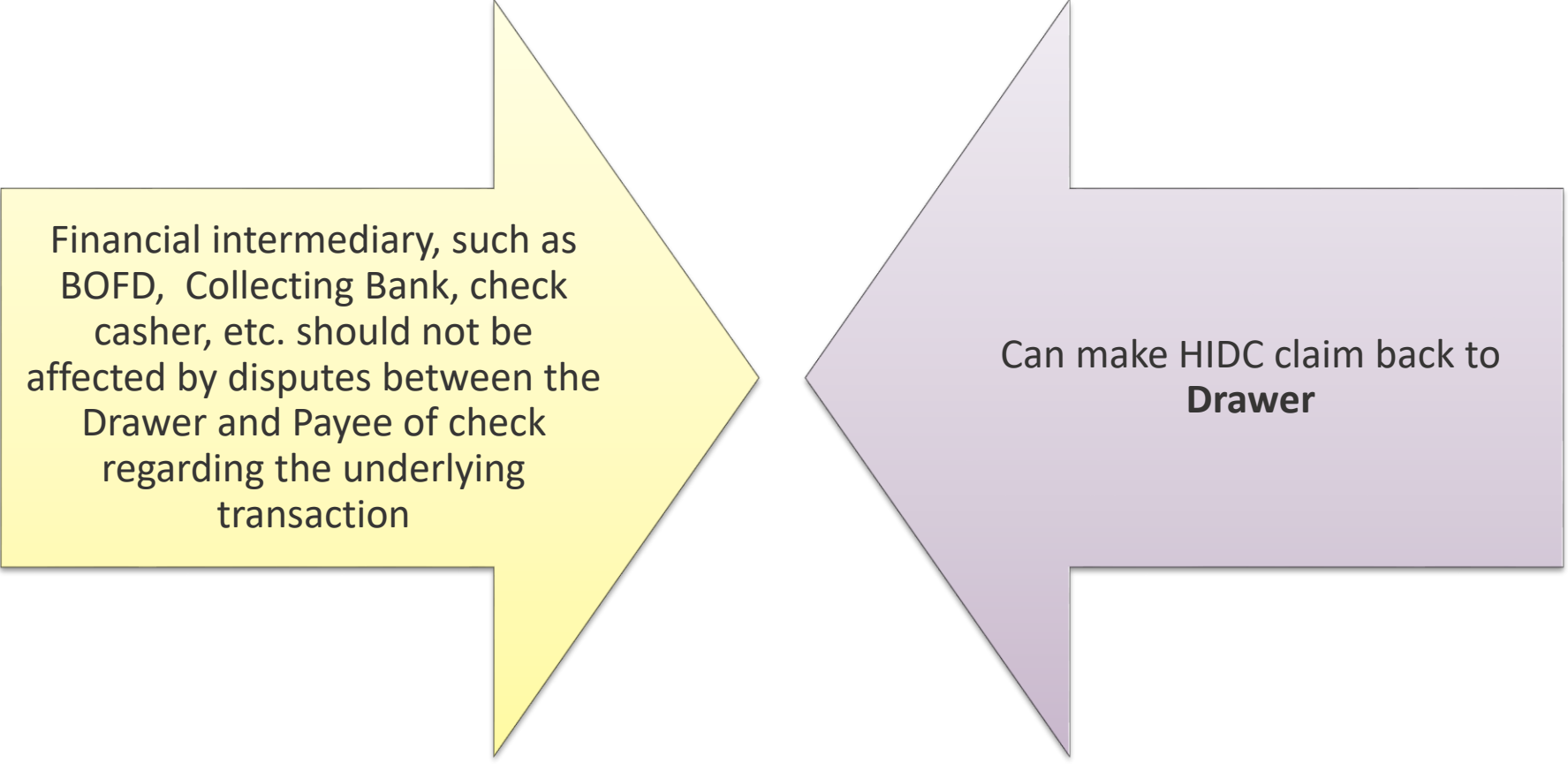
UCC 1-201(21) "**Holder**" means: (A) the person in possession of a negotiable instrument that is payable either to bearer or to an identified person that is the person in possession



Holder and Holder in Due Course (HIDC): *UCC 3-302*



Holder in Due Course (HIDC): *UCC 3-302*

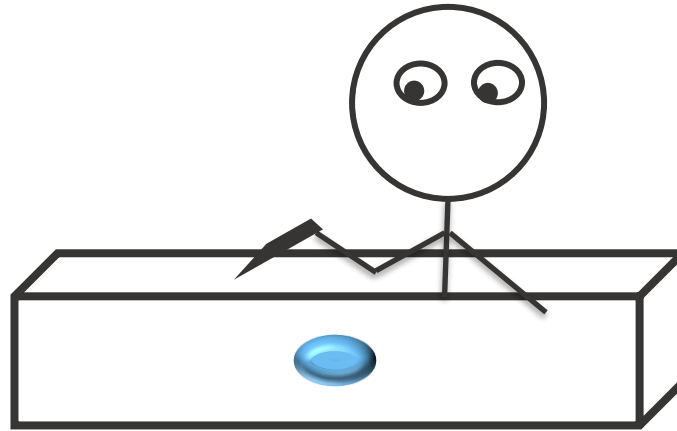


Financial intermediary, such as
BOFD, Collecting Bank, check
casher, etc. should not be
affected by disputes between the
Drawer and Payee of check
regarding the underlying
transaction

Can make HIDC claim back to
Drawer



HIDC Rights



Drawer

DRAWER: Means a person who signs a draft and orders payment (an owner of the checking account)



HIDC



So what do I do...?

...when Holder in Due Course demands payment from the **Paying Bank**

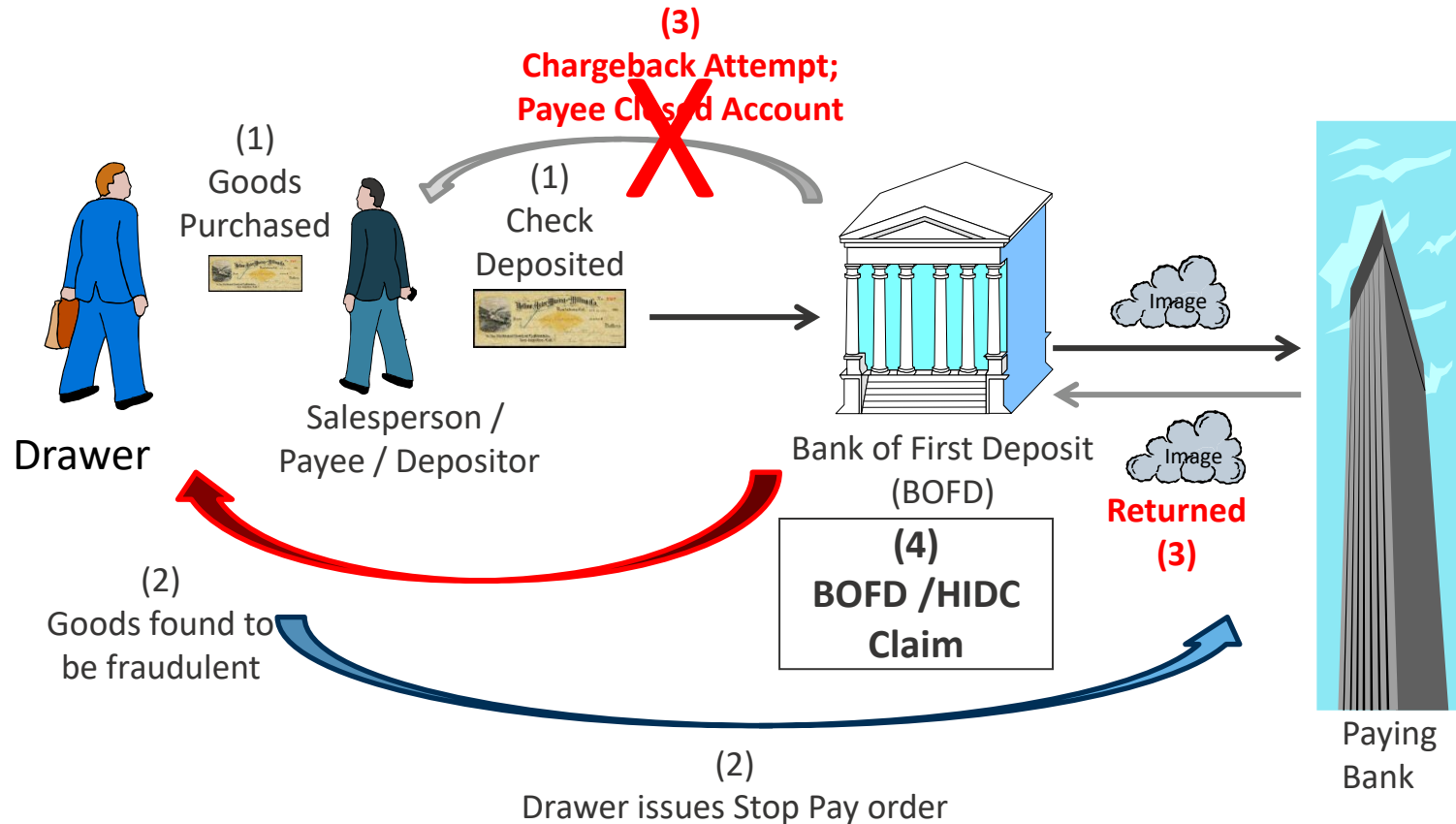
- If the Paying Bank is *not* the drawer
 - It is not subject to HIDC claim

...when my account holder is getting demands for payment from the HIDC

- Drawer is subject to HIDC claim
- Stopping a check payment does not cancel the *obligation* of the drawer
- Drawer and HIDC must resolve outside of banking channels



Holder In Due Course: *UCC 3-302*



- Depository Bank (BOFD) is Holder In Due Course
 - Can make claim back to Drawer



Wait, can a BOFD be a Holder in Due Course?

IF the BOFD	Took the <i>paper</i> item in good Faith
	Took item for value
	Without notice the item is <i>overdue</i> or has been dishonored
	Without notice signature was unauthorized or item altered
	Without knowledge of claims against it

AND the
check is
returned and
BOFD cannot
recover from
depositor

BOFD *can* make a Holder in Due Course claim against the
drawer



So how is this a *Good* thing?

HIDC is protected from any dispute between drawer and payee (PAID), and protected from any default by drawer (NSF, Account Closed, etc.)

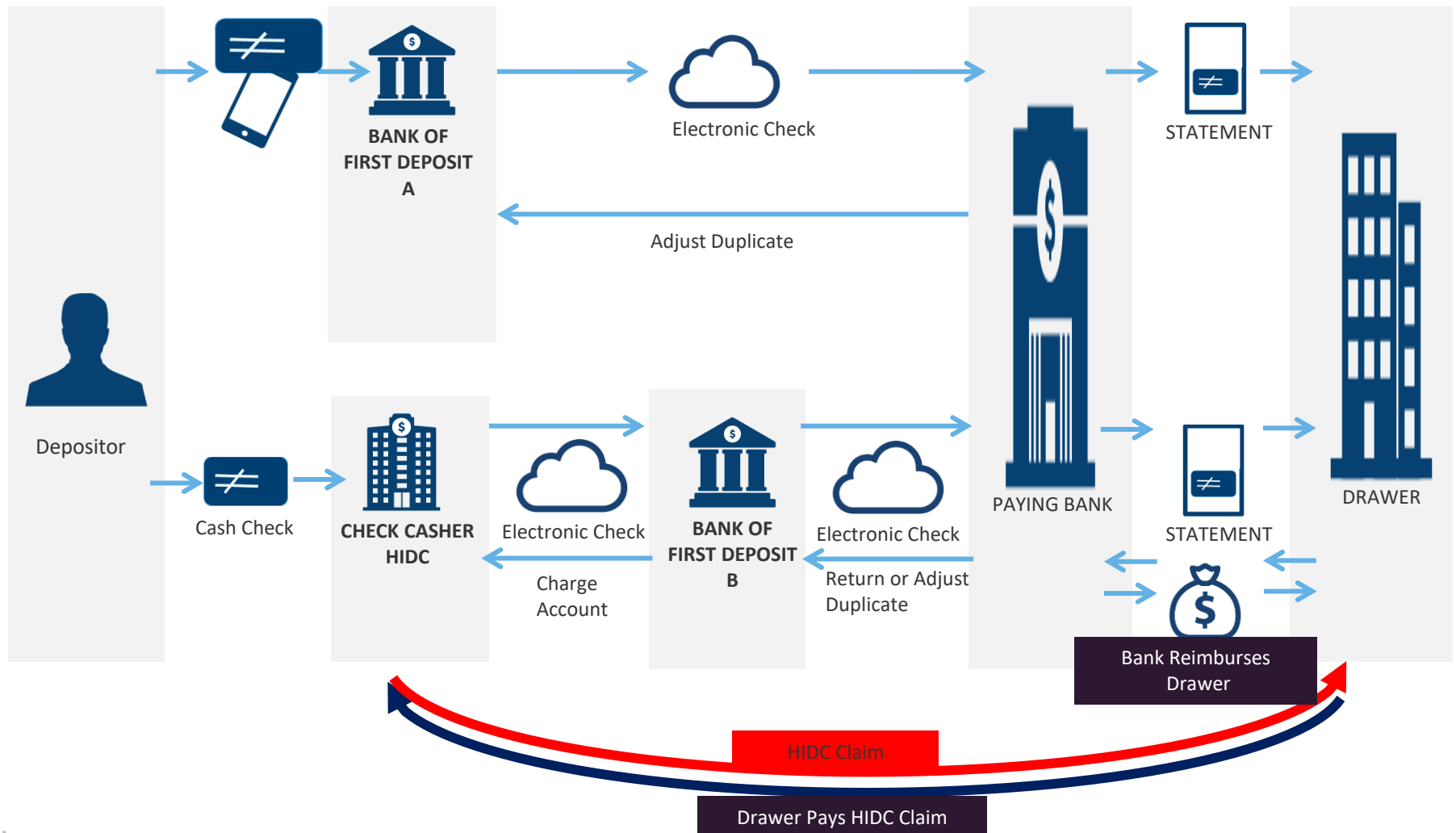
Risks to Drawer

- Not released from obligation to HIDC despite disputes between drawer and payee or inability to pay

Financial Intermediary has recourse



HIDC Scenario



HIDC and Remote Deposit Capture

A Paying Bank pays the same check twice

Accepted by BOFD A as *RDC deposit*

Accepted in paper by check casher or BOFD B

- *Without a restrictive indorsement*

Drawer's account is charged twice for the same check

Reg CC 229.34 (ii) "duplicate check" warranty

- No will be asked to pay a check that has already been paid

Drawer makes a claim against Paying Bank

Paying Bank must honor Reg CC warranty


- Reimburses drawer



So what happens when I adjust?


The depositor of the paper check may have holder in due course rights, and bring a holder in due course claim against the drawer after the duplicate check is returned/adjusted

- IF indorsement on the paper does not restrict the means and method of negotiation (i.e. for Remote Deposit only)



Adjusting the duplicate check that was deposited via RDC will debit the source

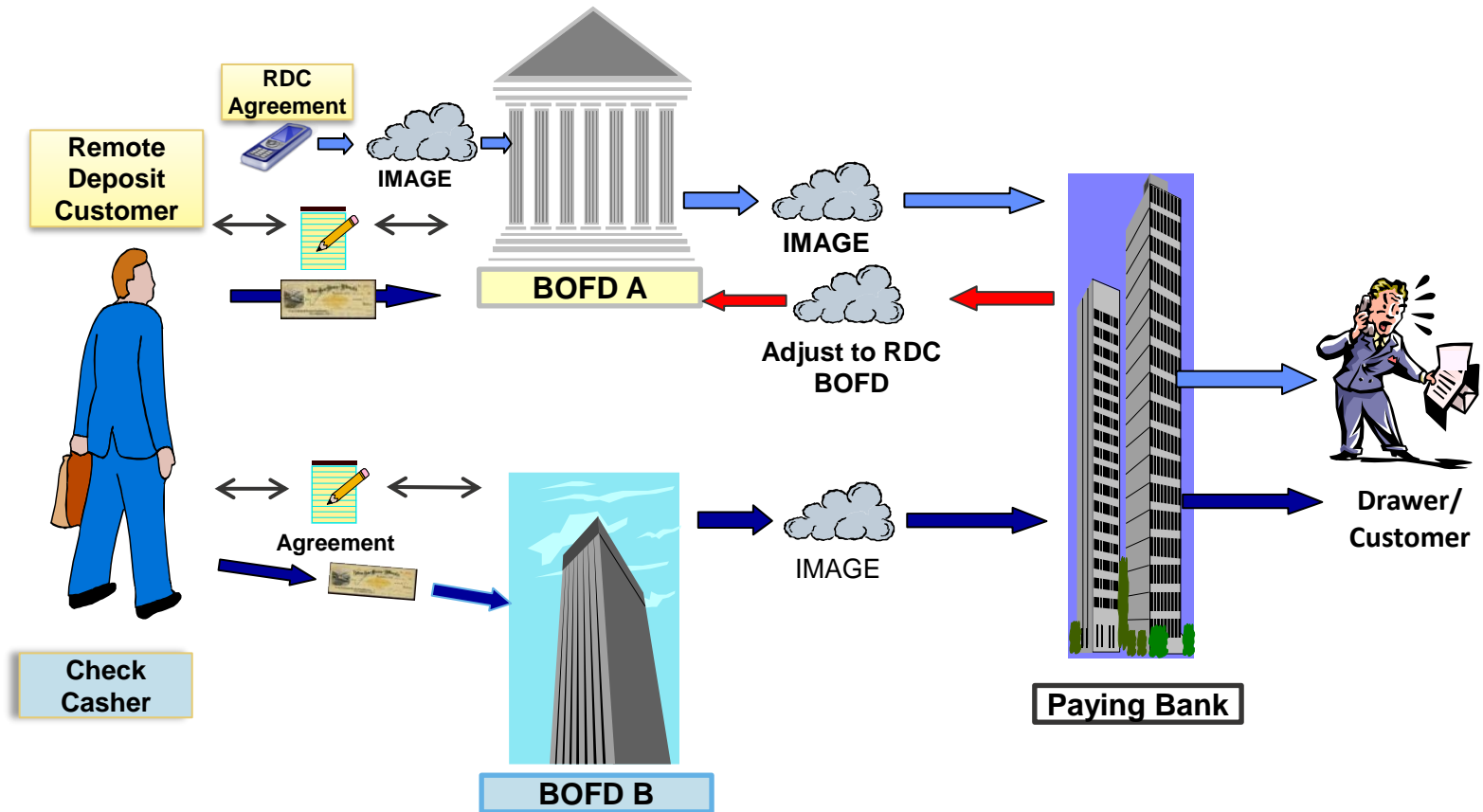
- The depositing customer who caused the duplicate
- The BOFD who provided the delivery service that facilitated the duplicate



Either duplicate check can be adjusted as 'PAID' if exchanged via FRB or 'Duplicate' if exchanged under ECCHO Rules



Duplicates: Adjustments



When your customer tells you about a duplicate, what's the *best* thing to do here?



And by the way . . .

*§229.30 Paying Bank's Responsibility for return of checks:
Expeditious return*

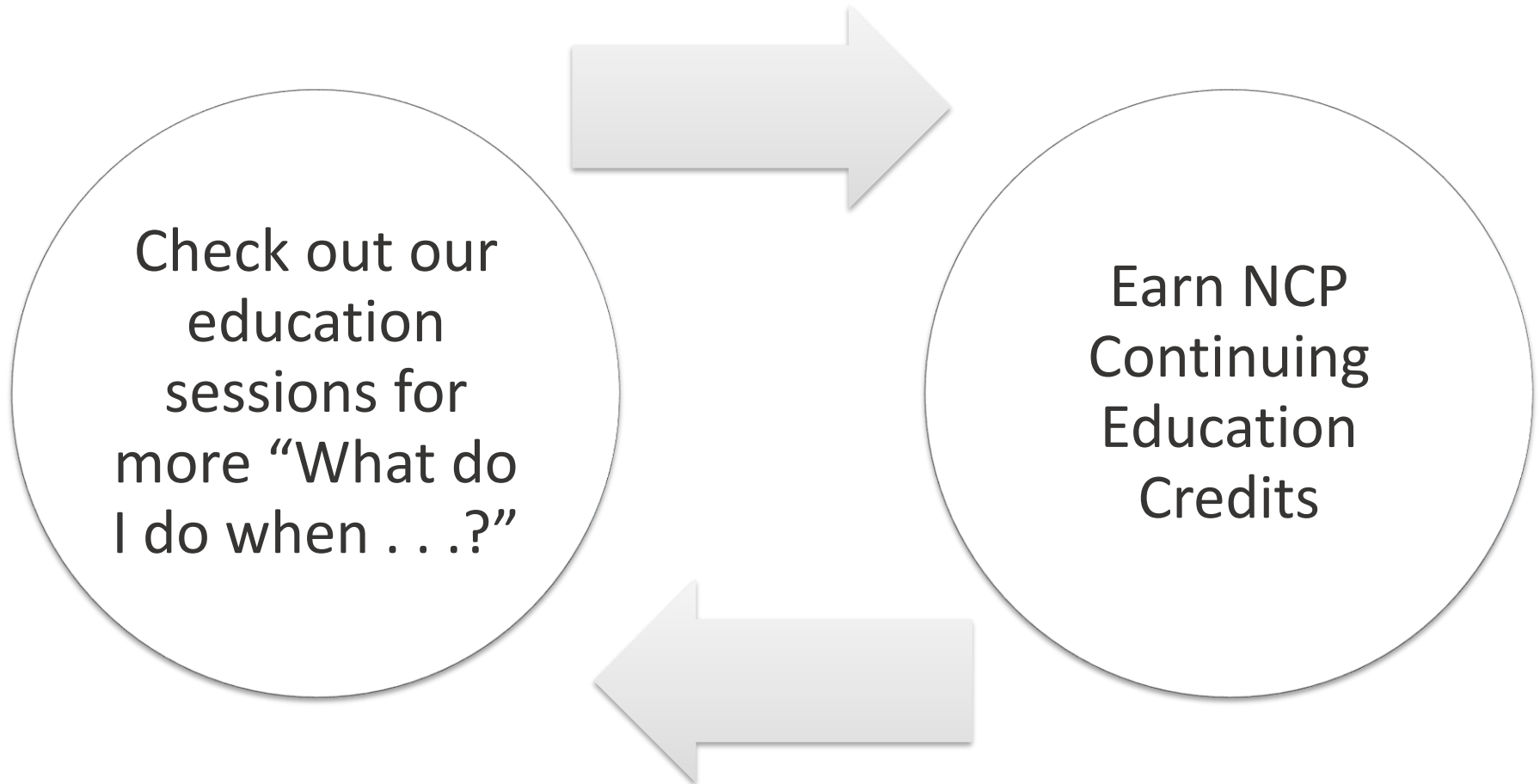
A paying bank returns a check in an expeditious manner if it

- Returns check such that the check would normally be received by the depository bank not later than **2:00 p.m.** (local time of the depository bank)
- By the second business day following the banking day on which the check was presented to the paying bank
- Notice of return for items >\$5,000 must be provided
 - Expeditious return can serve as notice

229.34 (d)(2) These warranties are not made with respect to checks drawn on the Treasury of the United States, U.S. Postal Service money orders, or checks drawn on a state or a unit of general local government that are not payable through or at a bank.



Looking for More Training?



For a complete listing of education events and on-demand sessions, please visit:
<https://www.eccho.org/education>



Thanks for your participation today!

ECCHO was established in 1990 as a not-for-profit clearinghouse to foster the electronic exchange of checks and to advocate for a more efficient check payments system. Now, as a service of The Clearing House Payments Company L.L.C., ECCHO has approximately 3,000 members comprised of U.S. depository financial institutions of all sizes. Member services provided by ECCHO include the ECCHO Operating Rules for private-sector image exchange, industry advocacy for the check payment system, payments education and the nationally recognized NCP accreditation program. Visit the ECCHO website for more information:

www.eccho.org

Dal Bolt, NCP, AAP

Director, Education

248.824.4908

dal.bolt@theclearinghouse.org

ecchoinfo@eccho.org

