

Where is the Rules Book for check?



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Session Topics – Where is the Rule Book?



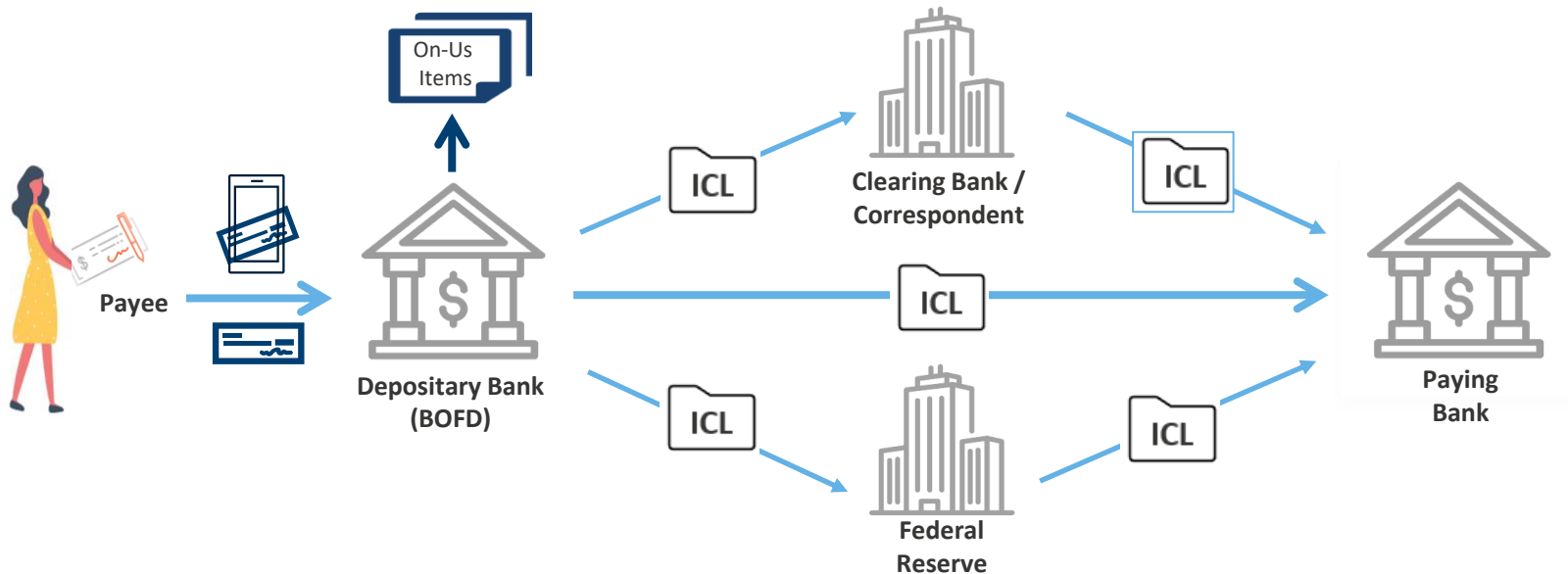
- Check Collection and Regulation Overview
- Uniform Commercial Code (UCC)
- UCC Transfer and Presentment Warranties
- Regulation CC
- ECCHO Rules
- Regulation J
- Federal Reserve Operating Circular 3
- Summary

Where is the Rule Book?

- Interbank exchange of checks subject to state and federal law
 - State Law: Uniform Commercial Code (UCC)
 - Regulations: Reg CC and Reg J
- In addition to state and federal law are clearinghouse rules and other agreements
 - Clearinghouse Rules (ECCHO Rules)
 - Agreement covering ECCHO members for images exchanged under uniform operating rules
 - Example: Address operational and technical requirements for image exchange
 - Federal Reserve Operating Circulars (OC)
 - Rules governing all exchanges to/from Federal Reserve Banks (FRB)
 - OC references Reg J for warranties

Check Collection 101

- Paper process flow shown through one or more channels to paying bank
- Regardless of how check is received, paper versus electronic, general processes remain the same



Interbank Exchange – General Process Flow

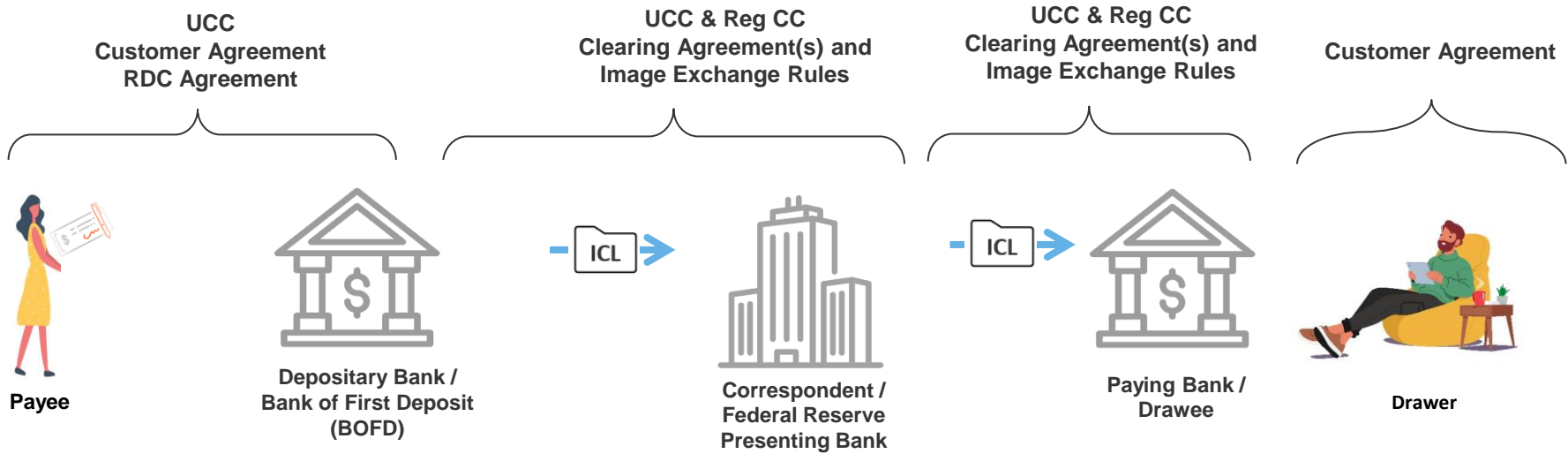
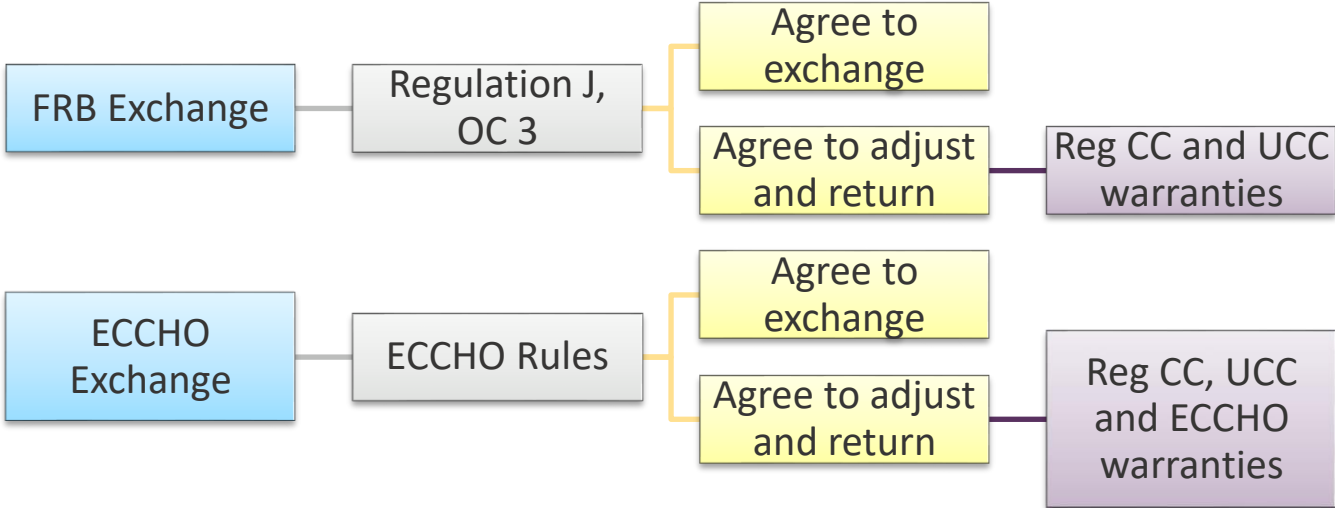
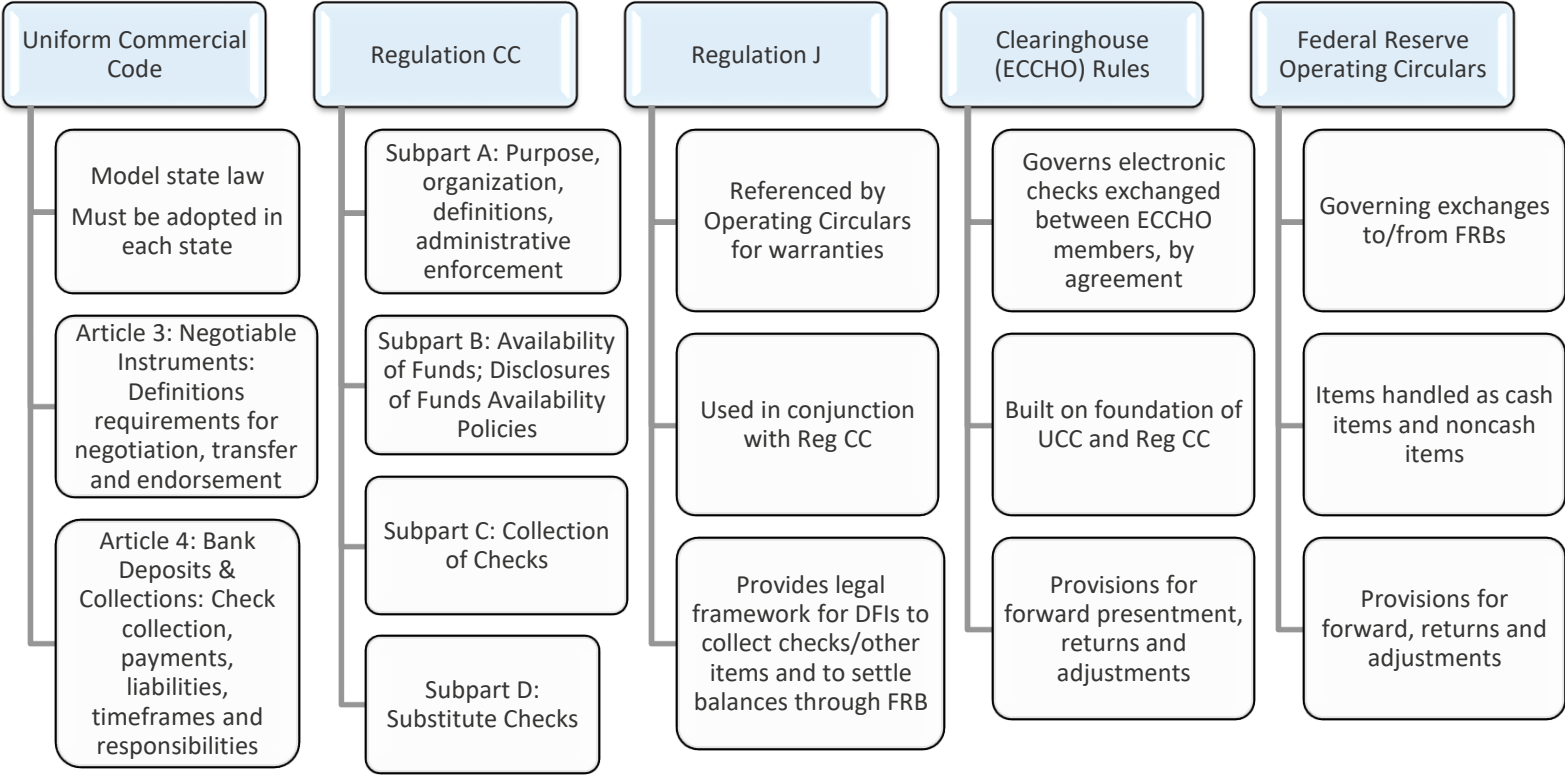


Image Exchange, Adjustment and Return *by Agreement*



Interbank Exchange of Checks – Check Governance



Uniform Commercial Code

Uniform Commercial Code (UCC)

Model state law developed with efforts towards uniform laws for sales and other commercial transactions in all 50 states

- UCC addresses most aspects of commercial law
- Set of standardized state laws governing financial contracts
- Must be adopted in each state

Examples of provisions:

- Provides transfer and presentment warranties
- Establishes general duty standards for parties to:
 - Act in Good Faith; and
 - Exercise Ordinary Care

Organized as Articles covering different subject area

- Article 3 covers negotiable instruments
- Article 4 covers bank deposits and funds transfers

Uniform Commercial Code (UCC): Purpose (first published 1952)

Article 1 – General Provisions and Definitions

Article 3 – Negotiable Instruments

Article 4 – Bank Deposits and Collections

(Enacted in all 50 states, District of Columbia, Puerto Rico, Guam & US Virgin Islands)

Set of standardized state laws that govern business and financial contracts

Model state law must be adopted by each state

Regulation and revisions written by experts in commercial law

Combined with case law, articles 3 & 4 document legal boundaries for most aspects of check processing

UCC Article 3 Overview

Negotiable Instruments

Establishes general duty standards for parties to:

- Act in Good Faith
- Exercise Ordinary Care

Definition and requirements of a negotiable instrument;
Negotiation, transfer and endorsement of these instruments

Sample topics:

- Standards of care required for processing checks
- Establishing the identity of the payee
- Negligence of maker in case of forgery or alteration
- Forgery and fraud loss allocation
- Employer's responsibility for employee fraud

UCC Article 4 Overview

Bank Deposits and Collections

Covers check collection, payment, liabilities, time frames and responsibilities

Any provision under Article 4 may be varied by agreement between bank and customer; except bank's duty to act in good faith and exercise ordinary care

Sample topics:

- When a bank may charge a customer's account
- Customer's right to stop payment
- Bank's option not to pay stale-dated items
- Customer's obligation to report unauthorized signatures

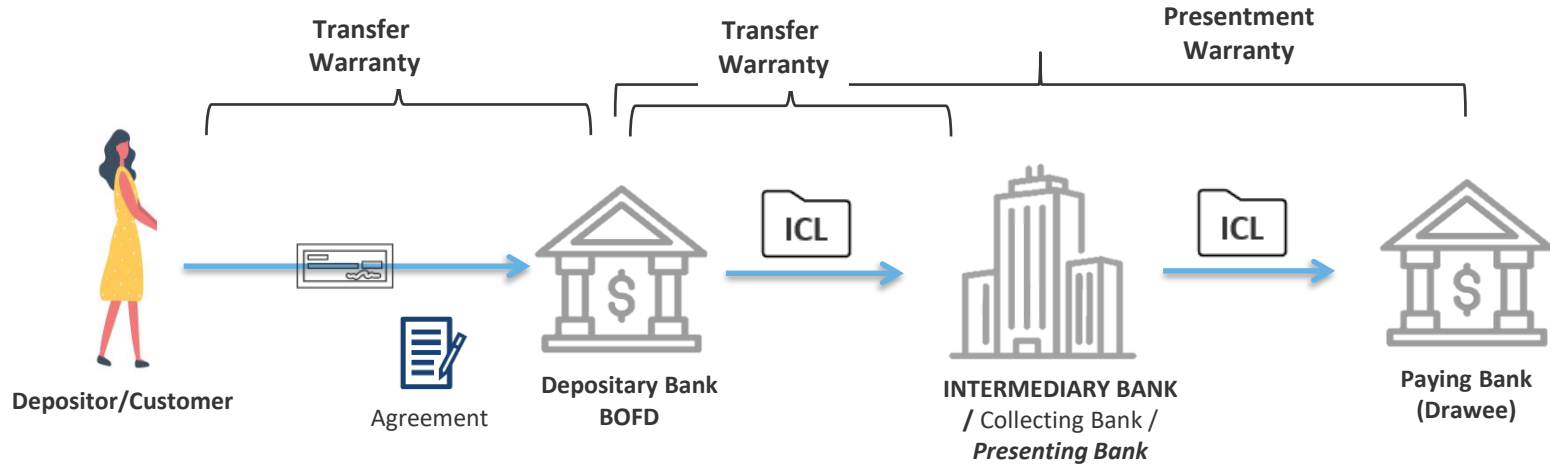
Uniform Commercial Code



- Identifies:
 - Transfer and Presentment Warranties
 - Drawer vs Maker
 - Definition of a check
 - Issue of an instrument
 - Date (and other date considerations) of a check
 - Payable To
 - Payee
 - ID of Payee
 - Amount
 - Incomplete and Alteration
 - Signature / Unauthorized Signature
 - Holder and Holder in Due Course
 - Overdue
 - Indorsement
 - Employer's Responsibility
 - Forged Drawer's Signature
 - Presentment
 - Properly Payable
 - Customer's Duty to Report Unauthorized Signature or Alteration

UCC Transfer and Presentment Warranties

UCC Warranties



- Transfer warranties travel with the item (chain of warranties) from Drawer to Payee, Payee to Depository Bank and Depository Bank to Intermediary/Collecting Bank
- Presentment Warranties are made from the Depository Bank to the Paying Bank
- Warranties ***provide recourse*** if breach of warranty occurs

UCC Transfer & Presentment Warranties

Transfer Warranties

Person or Collecting Bank
transferring the items warrants
(UCC 4-207):

- Entitled to enforce the item
- **All signatures on the item are authentic and authorized;**
- Item has not been altered;
- Item is not subject to a defense or claim
- Warrantor has no knowledge of any insolvency proceeding commenced with respect to the maker or acceptor or, in the case of an unaccepted draft, the drawer
- For remotely created consumer item, person on whose account the item is drawn authorized item and amount for which the item is drawn

Presentment Warranties

Person obtaining payment and
previous transferor presenting the
item warrants (UCC 4-208):

- Entitled to enforce draft, or authorized to obtain/acceptance of draft on behalf of a person entitled to enforce the draft;
- Item has not been altered; and
- **Warrantor has no knowledge that signature of the purported drawer of the draft is unauthorized;** and
- For remotely created consumer item, person on whose account the item is drawn authorized item and amount for which it is drawn

Regulation CC

Reg CC Overview



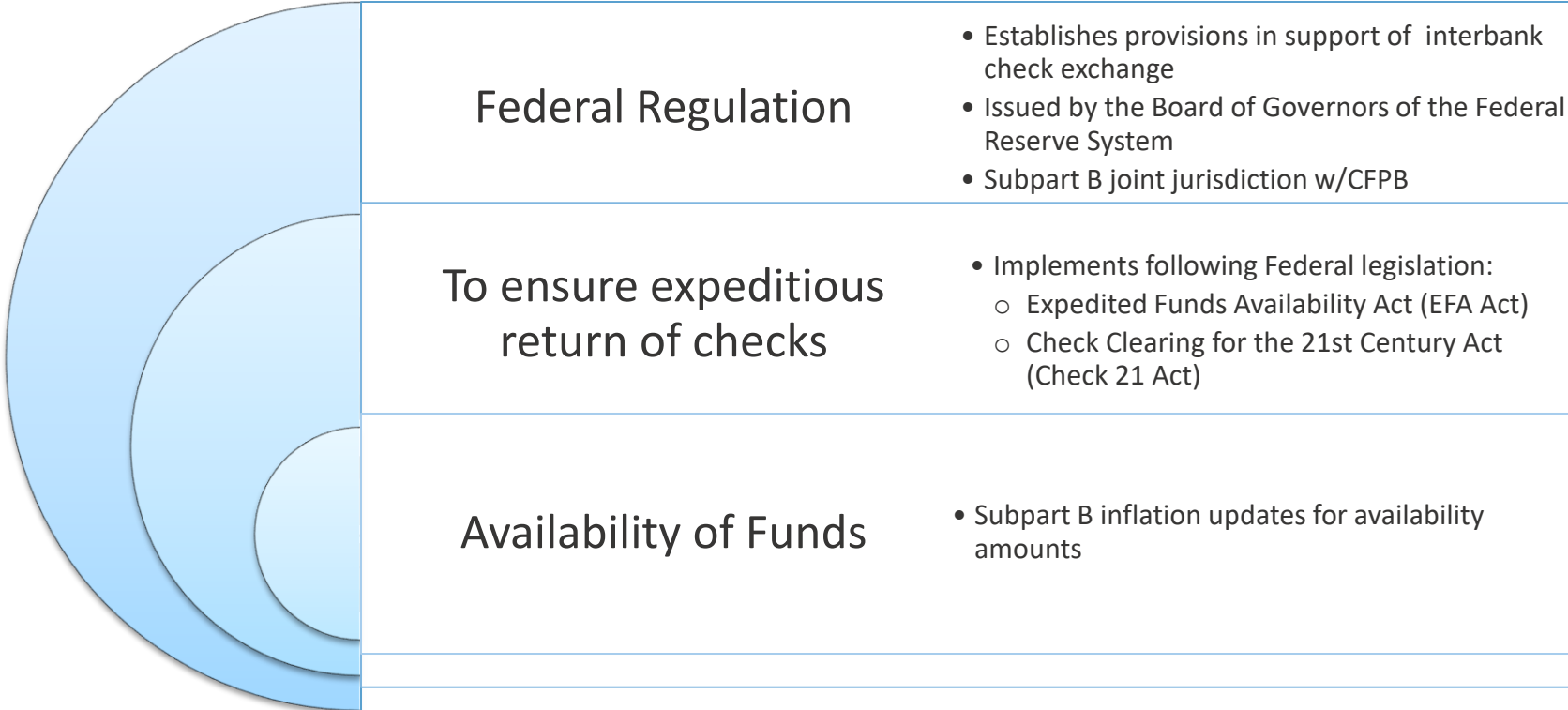
Divided Into four subparts:

- Subpart A:
 - ✓ Authority and Purpose
 - ✓ Definitions
- Subpart B: Funds Availability and Disclosure Requirements
 - ✓ Joint jurisdiction with Consumer Financial Protection Bureau (CFPB)
- Subpart C: Definition of electronic checks/electronic return checks
 - ✓ Paying Bank and Returning Bank Responsibilities
 - ✓ Depository Bank Responsibilities
 - ✓ Role of Rules and Agreements
 - ✓ Returns
 - ✓ Indorsements
 - ✓ Warranties and liabilities
- Subpart D: Substitute Checks and Consumer awareness

Appendices A – F

- Routing Number Guide
- Model Disclosures
- Commentary

Regulation CC Background



Reg CC Overview

Reg CC Subpart C: Applies directly to interbank electronic check exchange

Defers to interbank rules and agreements to establish many terms of exchange

- Private sector exchanges: ECCHO Rules
- Fed exchanges: OC3

Rules and Agreements: Establish many terms of exchange:

- Where/when/how electronic checks are delivered
- Will bank act as intermediary for exchange/return
- Exceptions/variations
- Eligibility rules for certain types of checks
- Limits on presentments
- Terms for exception handling and adjustments

Bank-to-customer agreements address customer relationship

- Deposits agreements
- Remote deposit capture (RDC) agreements

Reg CC: Warranties & Indemnities

- **Regulation CC**
 - Implements provisions of federal legislation:
 - Expedited Funds Availability Act (EFAA)
 - Check Clearing for 21st Century Act (Check 21 Act)
 - Defines electronic checks and electronic returned checks; and
 - Extends warranty coverage to these items
 - Requirements for expeditions returns and notice of non-payment
 - Settlement amount, encoding, and offset
 - Remote deposit capture (RDC) Indemnity
 - ECI definition & Indemnity
 - Transfer & Presentment of Remotely Created Check
 - Substitute checks

Regulation CC

- ▼ **Part 229** Availability of Funds and Collection of Checks (Regulation CC) 229.1 – 229.60
 - ▼ **Subpart A** General 229.1 – 229.3
 - § 229.1 Authority and purpose; organization.
 - § 229.2 Definitions.
 - § 229.3 Administrative enforcement.
 - ▼ **Subpart B** Availability of Funds and Disclosure of Funds Availability Policies 229.10 – 229.21
 - § 229.10 Next-day availability.
 - § 229.11 Adjustment of dollar amounts.
 - § 229.12 Availability schedule.
 - § 229.13 Exceptions.
 - § 229.14 Payment of interest.
 - § 229.15 General disclosure requirements.
 - § 229.16 Specific availability policy disclosure.
 - § 229.17 Initial disclosures.
 - § 229.18 Additional disclosure requirements.
 - § 229.19 Miscellaneous.
 - § 229.20 Relation to state law.
 - § 229.21 Civil liability.

Regulation CC

▼ Subpart C Collection of Checks

229.30 – 229.43

- § 229.30 Electronic checks and electronic information.
- § 229.31 Paying bank's responsibility for return of checks and notices of nonpayment.
- § 229.32 Returning bank's responsibility for return of checks.
- § 229.33 Depository bank's responsibility for returned checks and notices of nonpayment.
- § 229.34 Warranties and indemnities.
- § 229.35 Indorsements.
- § 229.36 Presentment and issuance of checks.
- § 229.37 Variation by agreement.
- § 229.38 Liability.
- § 229.39 Insolvency of bank.
- § 229.40 Effect of merger transaction.
- § 229.41 Relation to State law.
- § 229.42 Exclusions.
- § 229.43 *[Reserved]*

Regulation CC

▼ Subpart D Substitute Checks

229.51 – 229.60

§ 229.51 General provisions governing substitute checks.

§ 229.52 Substitute check warranties.

§ 229.53 Substitute check indemnity.

§ 229.54 Expedited recredit for consumers.

§ 229.55 Expedited recredit for banks.

§ 229.56 Liability.

§ 229.57 Consumer awareness.

§ 229.58 Mode of delivery of information.

§ 229.59 Relation to other law.

§ 229.60 Variation by agreement.

Regulation CC

Appendix A to Part 229

Routing Number Guide to Next-Day Availability Checks and
Local Checks

Appendix B to Part 229 [Reserved]

Appendix C to Part 229

Model Availability Policy Disclosures, Clauses, and Notices;
Model Substitute Check Policy Disclosure and Notices

Appendix D to Part 229 [Reserved]

Appendix E to Part 229

Commentary

Appendix F to Part 229

Official Board Interpretations; Preemption Determinations

Private Sector Rules: ECCHO



ECCHO Rules

Complete Rules

Rules Summary

ECCHO Adjustment
Matrix

ECCHO[®] OPERATING RULES AND COMMENTARY

The Clearing House Payments
Company L.L.C.

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ECCHO Operating Rules and Commentary

Exchange Agreements

- Must state agreement to exchange under the Rules
- Also include specifics for:
 - Business practices
 - Operational logistics
 - Details of rules provisions that may be varied by agreement
- May be incorporated with other network agreements or clearing house rules
 - Also known as banking practices agreement (BPA)
- Needed to cover customer-to-bank exchanges
 - Represents contract between bank and their customer
 - Example: Deposit account agreements
- Other product agreements
 - Image-enabled products/services agreements
 - Agreements with third-party provider
 - Address liabilities and responsibilities for creating and/or sending check images and substitute checks

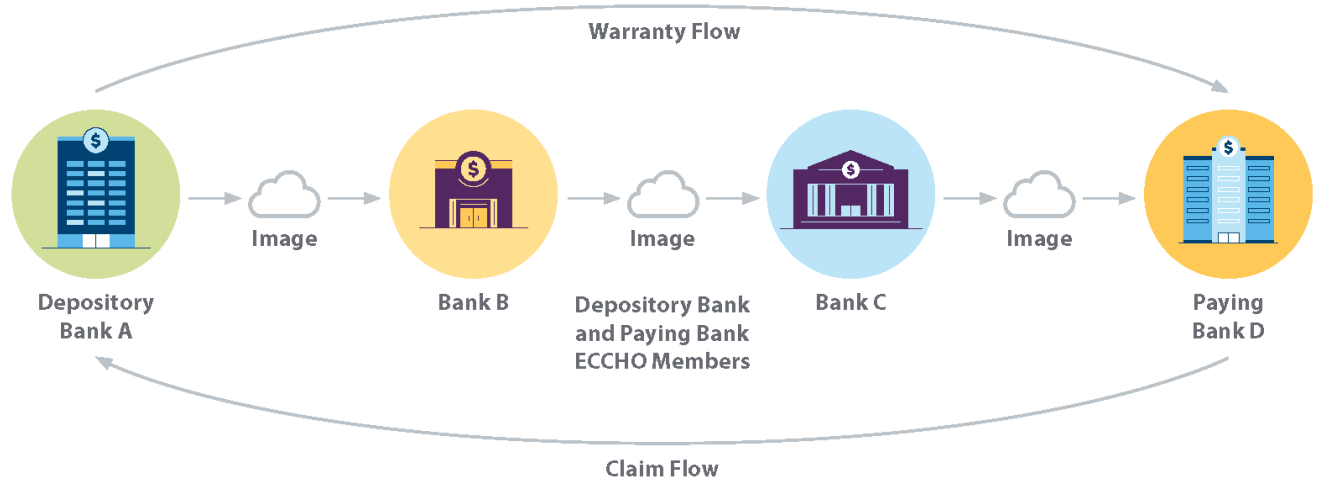
Exchange Agreements: General Considerations

- Agreement to use ECCHO Rules for exchange of electronic checks/electronic returned checks
- Provisions that can be varied by ECCHO rules
- Exchange network to be used
- Start dates for both forward and return exchanges
- Cut-off time
- Deadlines for receipt and acknowledgement
- Location for delivery of electronic checks/electronic returned checks
- Routing number identification (for File Header Records)
- Eligible routing number for exchange
- Image file formats and related standards or technical information
- Settlement process or provider
- Communication facility (archive, switch, etc.)
- Adjustments process or provider

ECCHO Rule 9



ECCHO Rule 9 Warranty Flow Directly to Paying Bank



Federal Reserve Regulation J

Regulation J

Provides legal framework for DFIs to collect checks and other items and to settle balances through the FRB

- References Reg CC: Definitions of electronic check and electronic returned check and other terms
- References Uniform Commercial Code (UCC): For terms not defined in regulation

Specifies terms and conditions under which FRBs will receive items for collection from, and present items to, depository institutions

- Supplemented by operating circulars issued by FRBs

Used in conjunction with Reg CC to establish rules under which DFIs may return unpaid checks through the FRB

- Provides rules for collecting and returning items and for settling balances via accounts on the books of FRBs

Federal Regulations

- **Regulation J**
 - Governs collection of checks, cash and noncash items and return checks handled by Federal Reserve Bank (FRB)
 - Provides rules for collecting and returning items, and settling balances
 - Referenced by FRB OC3 for warranties
 - Only applies if the FRB is an intermediary in the exchange
 - Subpart B - Funds Transfers Through Fedwire re: ISO 20022 messaging standard

Federal Reserve Operating Circular 3 (OC 3)

Federal Reserve Operating Circular 3 (OC3)

- Covers exchanges with FRBs
- Does not cover non-FRB image exchange

References Regulation J for warranties and indemnities provided:

- To FRB, by parties sending items to FRB for collection/return
- By FRB, in connection with the items they handle

OC3 includes:

- Definitions (not included in Reg CC and/or Reg J);
- Adjustments for claims related to ECIs;
- Adjustments for claims related to RDC duplicates;
- Technical/operational specifics to reference current X9 standards

Further Awareness

- Accredited Standards Committee X9
 - X9.100-111 Check Endorsements
 - X9.100-140 Image Replacement Documents
 - X9.100-160-2 MICR – Part 2 EPC Field Use
 - X9.100-187 Electronic Exchange of Check and Image Data
 - X9.100-188 Return Reasons For Check Image Exchange and IRDs
- FFIEC
- ECCHO Adjustment Matrix
- Federal Reserve Adjustment Quick Reference

Summary

Warranty and Indemnity Summary

Warranties/Indemnities come from different sources

- Federal regulations (Reg CC, Reg J)
- State laws (UCC)
- Rules and agreements (ECCHO Rules, Federal Reserve OC3)

What rules apply, determine if the item:

- Original physical check, substitute check (IRD), or image?

For image exchange, which rules, regs or agreements apply?

- For interbank exchange of electronic checks (derived from a paper check), Reg CC applies as a matter of law
- Then, determine the presentment/clearing channel:
 - Through the Federal Reserve - Reg J and OC3 apply
 - Through a clearinghouse - clearinghouse rules (e.g., ECCHO Rules)
 - Direct bank to bank (clearinghouse rules and/or other agreements)

Generally, warranties start at first financial institution that deals with substitute check or image

ECCHO and Fed Image Exchange Rules

- ECCHO Operating Rules and Commentary
 - Eligible Items
 - Full vs. Partial MICR
 - Repairs
 - Electronic check/Electronic returned check
 - Exchange of Canadian items
 - Imperfect images
 - Rule 8 and Rule 9
 - Adjustments
- Exchange Agreements
 - Business practices
 - Operational logistics
 - Rules varied by agreement
- Federal Reserve Bank Operating Circular 3
 - Cash Items and Noncash Items
 - Image Cash Letters/Return Letters
 - Presentment
 - Settlement
 - Returned Checks
 - Exceptions and Adjustments
- Electronic Access to Check Services (OC5)
- Participating Bank Agreement
 - Operational logistics

References



- UCC: <https://www.law.cornell.edu/ucc>
- Reg CC: <https://www.ecfr.gov/current/title-12/chapter-II/subchapter-A/part-229?toc=1>
- ECCHO Rules: <https://www.ecchoonline.org/s/login/>
- Reg J: <https://www.federalreserve.gov/supervisionreg/regjcg.htm>
- FRB Operating Circulars: <https://www.frbervices.org/resources/rules-regulations/operating-circulars.html>

Questions

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