Canadian Cheques – Processing and Clearing

March 3, 2021

Presented by:
William (Bill) Saffici
Managing Director
Saffici Payment Consulting LLC
Speaker Introduction
Session Overview

• Overview of Canadian Banking
• Canadian Cheque Image Evolution
• Status of Canadian FI Progress
• Characteristics of Processing
• Cross Border Exchange
• ECCHO Rules for Clearing Canadian items in U.S.
• Survey – What ECCHO Members are Doing with Canadian Image Clearing
Banking in Canada

• Banking in Canada is under Federal Jurisdiction

• A variety of legislation and statutes manage national banking
  ▪ Bank Act: Defines ‘bank’
  ▪ Bills of Exchange Act: Defines ‘cheque’ and other payment instruments
    – Extended in 2007 to add image of a cheque as a Bill of Exchange

• Canadian Payments Act - Establishes the Canadian Payments Association, now called Payments Canada
Banking in Canada

• Payments Canada  (www.payments.ca)
  ▪ IS - The operating body that governs payments clearing and settlement in Canada at a national level
    – Manages the central settlement system (ACSS) for cheque and EFT
    – Manages the network for exchange of EFT and Image Captured Payment (ICP) files
  ▪ IS NOT - A standards development organization
    – Provides standards specific to its mandate, supporting its members in participating in the national payments process and owns the standards
  ▪ Cheques in Canada (30 min tutorial)
    https://www.youtube.com/watch?v=SDre9iWSgD8
Banking in Canada

• Canadian Financial Institutions (FIs) are divided into:
  ▪ ‘Direct Clearers’ (DC) and ‘Indirect Clearers’ (IC)
    – Direct Clearer (DC) – Participates directly in interbank exchange and settlement
    – Indirect Clearer (IC) - Contracts services of DC to represent it for exchange of other FI items that IC has taken for deposit
  ▪ 12 Direct Clearers:

<table>
<thead>
<tr>
<th>Direct Clearers</th>
</tr>
</thead>
<tbody>
<tr>
<td>001: Bank of Montreal</td>
</tr>
<tr>
<td>002: Bank of Nova Scotia</td>
</tr>
<tr>
<td>003: Royal Bank of Canada</td>
</tr>
<tr>
<td>004: Toronto Dominion Bank</td>
</tr>
<tr>
<td>006: National Bank of Canada</td>
</tr>
<tr>
<td>010: Canadian Imperial Bank of Commerce</td>
</tr>
<tr>
<td>016: HSBC Bank Canada</td>
</tr>
<tr>
<td>039: Laurentian Bank of Canada</td>
</tr>
<tr>
<td>117: Bank of Canada - Receiver General</td>
</tr>
<tr>
<td>219: ATB Financial</td>
</tr>
<tr>
<td>815: Federation des casisses Desjardins</td>
</tr>
<tr>
<td>869: Central 1 Credit Union</td>
</tr>
</tbody>
</table>

• Approximately 100 Indirect Clearers
Banking in Canada

Relationship Between IC and DC is for Deposited, Inclearing and Return Items

* Separate US ABA/Dollar from CDN Dollar

National Check Payments Certification
Cheque Image Evolution

• 2002 – 2008 - Truncation and Electronic Cheque Presentment (TECP) Project
  ▪ Mandated exchange - ALL FINANCIAL INSTITUTIONS
  ▪ Complex integration among/between direct clearers and indirect clearers

• Payments Canada Image Rule Project
  ▪ **Phase I** – adopted December 2009 – effective June 1, 2010. Approved Rule A10 (images of cheques) and Rule A12 (image security standard)
  ▪ **Phase II** – adopted December 2010 – effective June 1, 2011. Approved amendments to Rule A10 related to creation and use of Return Replacement Documents (RRD)
Cheque Image Evolution

• Payments Canada Image Rule Project (cont’d)
  ▪ **Phase III** – adopted *March 2012* – effective *October 1, 2012*. Approved amendments to Rule A10 related to creation and use of Clearing Replacement Documents (CRD)
  ▪ **Phase IV** – adopted *June 2013* – effective *August 12, 2013*. Approved Final Rule amendments to allow Direct Clearers to exchange electronic payment files containing Image Captured Payments (ICP) with partner that has agreed to participate in ICP Exchange

• Bilateral Agreements

Cheque Image Migration Path

- Retain aspects of current process
- Develop New

<table>
<thead>
<tr>
<th>Infrastructure Changes</th>
<th>CRD and RRD Print Capability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single Electronic Processing Site</td>
<td>All Source Capture Channels (RDC, Mobile, Branch, ATM)</td>
</tr>
<tr>
<td>Image Exchange Function</td>
<td>Day 2</td>
</tr>
<tr>
<td>National Clearing (Optional)</td>
<td></td>
</tr>
<tr>
<td>• Cash letter per region included in one ICP (X9)</td>
<td></td>
</tr>
</tbody>
</table>

- Movement Away from Outsourcing
  - 3 of largest FIs moving to in-house
  - 2 of largest FIs moving to new outsource provider
  - Technical and, more importantly, Operational Impact
Cheque Image Exchange Migration Status

Bank of Canada does not participate in exchanges. Receiver General is expected to begin receiving Q2 2021
Cross Border Exchange - Overview

• Depositary Agreements with Canadian FI

• Exchange Rules/Depositary Agreements – within US
  - ECCHO Rules for clearing of Canadian Cheques

CUSTOMER

Canadian Cheque

ECCHO Member
Bank A
Sending Bank

Returnee Member

ECCHO Member
Bank B
Receiving Bank

Gateway Receiving Bank

Canadian Correspondent FI
(Point of Entry)

Canadian Paying Bank

ECCHO Rules

Correspondent Agreement

Canadian Law and Canadian Payment Rules

* Separate US ABA/Dollar from CDN Dollar
Cross Border Exchange

• Northbound Forward Exchange

CUSTOMER

Canadian Cheque

U.S. BOFD

U.S. Correspondent Bank

Canadian Correspondent FI (Point Of Entry)

Canadian Paying FI DC or IC

Canadian $ Image or Paper Exchange

U.S. $ Image or Paper Exchange

US/Canadian Border

U.S. $ Image or Paper Exchange

Canadian $ Image or Paper Exchange

* Separate US ABA/Dollar from CDN Dollar
Cross Border Exchange

• Northbound Return Exchange
Cross Border Exchange

• Southbound Forward Exchange
Cross Border Exchange

• Southbound Return Exchange

Canada

U.S.

CUSTOMER

Returned Item

Canadian FI
DC or IC

Canadian Correspondent FI
(Point Of Entry)

U.S. Correspondent Bank (paper or image) or FRB (paper only)

U.S. Paying Bank

US/Canadian Border

U.S. $ Return – Image or Paper

U.S. $ Return – Image or Paper

U.S. $ Return – Image or Paper
Cross Border Exchange

• Processing Standards
  ▪ Northbound – Companion Document to follow Standard 015
  ▪ Southbound – Companion Document to follow X9.100-187
  ▪ Bitonal image – 200 dpi in tiff - standard to both countries

• R/T Format
  ▪ Retain “dash” in RT Field ex. 12345-010 In Record 25

• US Dollar vs Canadian Dollar Funded Accounts
  ▪ Both have XXXXX-YYY RT format
  ▪ US Dollar Funded Accounts – “45” in tran code field. See Appendix A for list of other characteristics
  ▪ Canadian Funded Accounts – “Hand-written” – US FUNDS
  ▪ Canadian Cheques without TC 45 will likely require operator review for proper designation
Cross Border Exchange

• Return Item Collection
  ▪ Canadian FI Return Item Reason Codes **DO NOT** map directly with US Return Item Codes
  ▪ US BOFD **cannot** represent returned Canadian cheque
  ▪ Several conditions when BOFD can “re-exchange” Return Item (presented as first-time item)
  ▪ Canadian FIs can return some categories of items up to 90 days and 6 years after presentment
## Cross Border Exchange

### Return Item Collection – Reason Codes

<table>
<thead>
<tr>
<th>Description</th>
<th>Code</th>
<th>Code</th>
<th>Description</th>
<th>Time Limit for Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>NSF - Not Sufficient Funds</td>
<td>‘A’</td>
<td>A</td>
<td>Insufficient Funds</td>
<td></td>
</tr>
<tr>
<td>Stop Payment</td>
<td>‘C’</td>
<td>B</td>
<td>Payment Stopped</td>
<td></td>
</tr>
<tr>
<td>Post Dated</td>
<td>‘H’</td>
<td>C</td>
<td>Post Dated</td>
<td>up to and including the due date</td>
</tr>
<tr>
<td>Stale Dated</td>
<td>‘G’</td>
<td>D</td>
<td>Stale Dated</td>
<td></td>
</tr>
<tr>
<td>Closed Account</td>
<td>‘D’</td>
<td>J</td>
<td>Account Closed</td>
<td></td>
</tr>
<tr>
<td>Altered/Fictitious Item/Suspected Counterfeit/Counterfeit</td>
<td>‘N’</td>
<td>E</td>
<td>Counterfeit Item</td>
<td></td>
</tr>
<tr>
<td>Refer to Maker</td>
<td>‘S’</td>
<td>U</td>
<td>Refer to Maker</td>
<td></td>
</tr>
<tr>
<td>Not Authorized (Includes Drafts) – Unauthorized item such as a draft</td>
<td>‘Q’</td>
<td>K</td>
<td>Not Eligible for Clearing - Telecheque</td>
<td>90 calendar days</td>
</tr>
<tr>
<td>Duplicate Presentment (Supporting documentation shall be readily available)</td>
<td>‘Y’</td>
<td>N</td>
<td>Duplicate Payment</td>
<td>90 calendar days</td>
</tr>
</tbody>
</table>

See Appendix B for complete information
Cross Border Exchange

• Adjustments
  ▪ An adjustment, as known in US, is not used in Canada
  ▪ Canadian FIs enforce use of the Return process
  ▪ ECCHO rules permits debit or credit adjustments to respective depositary account
  ▪ ECCHO Adjustment code for adjustments within US
Overview of ECCHO Rules for Canadian Items
ECCHO Canadian Item Rules

• Members requested ECCHO Rules coverage for Canadian items

• Subcommittee formed

• Payments Canada and Canadian FIs participated

• Commentary includes:
  – Pertinent cases
  – Significant differences (i.e. returns)
  – Some Canadian law

• Rules approved (Section XVIII) effective August 3, 2015
ECCHO Canadian Item Rules

• New Definitions for Exchange of Images of Canadian Items (see Definitions section)
  ▪ Canadian Law
  ▪ Canadian Item
  ▪ Canadian Correspondent FI
  ▪ Canadian Paying FI
  ▪ Canadian Paper Return Item
  ▪ Gateway Receiving Bank
ECCHO Canadian Item Rules

• General Provisions – Application of Rules
  ▪ Apply within U.S. for ECCHO member exchanges prior to exchange with Canadian FI - Northbound
    — Southbound exchanges of U.S. items already covered by ECCHO rules
  ▪ Allowance for section to be varied by agreement

• Application of law to Canadian items
  ▪ Canadian law applicable
    — Members responsible to understand applicable Canadian law
    — ECCHO Rules do not change Canadian law or rights under it
  ▪ U.S. law applicable to obligations under Rules
ECCHO Canadian Item Rules

• Forward Exchange

CUSTOMER

Canadian Cheque

ECCHO Member
Bank A
Sending Bank

U.S. $ Image Exchange

Canadian $ Image Exchange

ECCHO Member
Bank B
Receiving Bank

Gateway Receiving Bank

Correspondent Agreement

Canadian Law and Canadian Payment Rules

Canadian Correspondent FI
(Point of Entry)

Canadian Paying FI

ECCHO Rules

U.S. $ Image Exchange

Canadian $ Image Exchange

Canadian $ Image Exchange

U.S. $ Image Exchange

Canadian $ Image Exchange

U.S. $ Image Exchange

Canadian $ Image Exchange

U.S. $ Image Exchange

Canadian Paying FI

National Check Payments Certification
ECCHO Canadian Item Rules

• Return Exchange

CUSTOMER

ECCHO Member Bank A
Returnee Member

ECCHO Member Bank B
Gateway Receiving Bank
Returning Member

Canadian Correspondent FI
(Point of Entry)

Canadian Paying FI

ECCHO Rules

Correspondent Agreement

Canadian Law and Canadian Payment Rules

Returned Item

U.S. $ Return – Image or Paper

Canadian $ Return – Image or Paper

U.S. $ Return – Image or Paper

Canadian $ Return – Image or Paper

Canadian $ Return – Image or Paper

U.S. $ Return – Image or Paper

Canadian $ Return – Image or Paper
ECCHO Canadian Item Rules

• Applies to Items eligible for exchange under Canadian Law

• Canadian image is “item” under UCC, not “check” under Reg CC
  ▪ US Banks handle Canadian Image and Paper Return as collecting bank under Code
  ▪ Provisions of UCC - Transfer warranties apply

• Destruction of Canadian Item within 120 days
ECCHO Canadian Item Rules

- Depositing customer agreement required
  - Responsible for check deposit relationship with customer
  - Review current terms of account agreement and consider needed changes
  - If RDC, destroy original cheque within 120 days
    - Rules do not cover RDC
  - Form of item that customer will receive for return
  - Prohibition of redeposit without permission
  - Reg CC availability does not apply to foreign cheques
  - Exchange Rate on Foreign Items
ECCHO Canadian Item Rules

• Separate electronic files for items of different currency
• Applicable Industry formats and standards required
• Gateway Receiving Bank may establish additional operational or formatting requirements
  ▪ Based on its agreement with Canadian Correspondent FI
  ▪ Responsible for exchange with Canadian Correspondent FI
• Image and Return RRD of Canadian Item is legal equivalent of Canadian item
ECCHO Canadian Item Rules

• Canadian Image Exceptions - Rejects, returns, correction or adjustment
  ▪ Reg CC and UCC return timeframes do not apply
  ▪ Can be returned or rejected by US or Canadian FI
  ▪ May return Image or Canadian Paper RRD to FI that previously sent and maintain return reason codes
  ▪ Return or reject sent to Member who originally transmitted or to another Member that agrees to receive return or reject
  ▪ If Gateway Receiving Bank returns paper return, other Members maintain in paper form during return process
  ▪ Subsequent presentment of returned items only if instructed or eligible under Canadian Law
  ▪ Image can create an Official Copy of item
ECCHO Canadian Item Rules

• ECCHO Adjustment Rules apply
  ▪ Items are not handled as adjustments within Canada - expect returns and handle as adjustment in U.S.

• Cannot create Substitute Check from Canadian item

• Warranties and Indemnification
  ▪ ECCHO warranties apply to Canadian image and Canadian Paper Return Item
  ▪ Sending Bank indemnifies Receiving Bank except for its failure to exercise ordinary care or act in good faith
  ▪ If Gateway Receiving Bank receives return warranty from Canadian FI, it makes same warranty

• Financial settlement for Canadian Items
  ▪ No unique rules
  ▪ Members may have separate settlement processes for currency exchange
Survey – ECCHO Members and Canadian Image Exchange

Saffici Payment Consulting was provided with the responses void of respondent name with a Tier level established by ECCHO
Survey – What ECCHO Members Are Doing

Survey Respondents by Tier

- Tier 1: 52%
- Tier 2: 13%
- Tier 3: 26%
- Tier 4: 9%

Respondents Clearing Canadian Cheques

- Yes: 57%
- No: 43%
Survey – What ECCHO Members Are Doing

Respondents Clearing Direct with Canadian FI

- 71% Direct
- 29% Indirect

Respondent Offers Canadian Correspondent Clearing Service

- 29% Yes
- 71% No

3 Respondents clearing US Dollar Funded only
1 Respondent clearing CRDs converting to image

1 Respondents has “grandfathered” correspondents only
Survey – What ECCHO Members Are Doing

Average Monthly Volume - Respondents Clearing Canadian Cheques
Survey – What ECCHO Members Are Doing

Respondents with Plans to Clear Canadian Cheques

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>50%</td>
<td>50%</td>
</tr>
</tbody>
</table>

Timeframe To Implement Canadian Cheque Clearing

<table>
<thead>
<tr>
<th></th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Q2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Q3</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Q4</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Resp 1: Within 12 months
Resp 2: Not Yet Determined
Resp 3: Prior to Year-End
Resp 4:
Resp 5:
Survey – What ECCHO Members Are Doing

Receive US Checks (Image) from Canadian FI

- Yes: 17%
- No: 83%

Monthly Volume:
1 Respondent - 400,000 items
Survey – What ECCHO Members Are Doing

• Two Questions Were Asked of the Respondents:

1. Please provide any **general technical or operational information relative to your preparation** for image-based Canadian Cheque Clearing that may improve industry efficiency of such clearing.

2. Please provide any **general technical or operational information relative to your daily processing** of image-based Canadian Cheque Clearing that may improve industry efficiency of such clearing.
Survey – What ECCHO Members Are Doing

• Distinguish between US Dollar Funded Cheque and Canadian Funded Cheque
  – TC 45 is required on US Dollar Funded Cheques
  – Maker will write “US Dollar Funds” on Canadian Funded Cheque
  – Edit routine should examine for TC 45
  – Non-TC 45 items should be presented for operator review and TC 45 entered for those stating US Dollar Funds
  – Option to pre-sort physical items before capture and have designated capture routines. Difficult with teller and branch capture.
  – Examine your institution policy - when and how exchange rate affects customer
Survey – What ECCHO Members Are Doing

• Creation and Submission of ICL; Separate ICL Files by Dollar Denomination; ICL File Format
  – Canadian RT Validation
  – Proper identification of items (see prior slide)
  – File format - Northbound items will follow the Canadian Standard 015, which is a Companion Document to X9.100-180-2008
    • Agreement with FI that you are presenting to (Canadian FI or US Correspondent) will provide specifications.
    – NOTE: There is no standard among Canadian FIs regarding the file format of Northbound items. Ensure that you understand their requirement in how they address “deposit” X9 files, specifically credit record (Type 25 or Type 61).
Survey – What ECCHO Members Are Doing

• Northbound Return Items
  – Highly probable to receive in paper form – RRD (Return Replacement Document)
  – Return Reason Codes DO NOT map to US Return Reason Codes
  – Wrong Currency - high percentage
  – CANNOT represent items
Survey – What ECCHO Members Are Doing

• Daily Exchange Rate
  –Applying exchange rate to depositing customer
    • At time of deposit or back office
  –How is this coordinated with the cash letter amount presented either to the Canadian FI or US Correspondent Bank for settlement?
  –How is the exchange handled when an item is returned?
Q & A Discussion
Appendices
Appendix A – Canadian Currency

• The following excerpts contain more specific information on the identification of the various currency designations when dealing with Canadian cheques

  ▪ Standard 006 – page 29 “Payable through U.S. Dollar”
    https://www.payments.ca/sites/default/files/standard006eng.pdf
  ▪ Standard 006 – page 53 “Transaction Code Section”
    https://www.payments.ca/sites/default/files/standard006eng.pdf
Appendix B – Return Items

• Understanding Canadian Return Reason Codes


• Content:
  – “Reason Match” – shows return reason codes that have same/similar meaning and identifies those with extended return times and manner by which the return can be presented
  – “Re-Exchange Matrix” - shows the return reasons eligible for presentment as a new item (not representment)
Appendix C – Canadian Rules

• All Canadian Rules and Standards can be found at
  

• The specific rules and standards applicable to this presentation are:
  
    
    https://www.payments.ca/sites/default/files/standard015eng.pdf
  
  ▪ Payments Canada Rule A4 - Returned and Redirected Items (April 27, 2020)
    
    https://www.payments.ca/sites/default/files/a4eng.pdf
  
  ▪ Payments Canada Rule A10 - Image Rule (January 2, 2021)
    
    https://www.payments.ca/sites/default/files/a10eng.pdf
## Appendix D – Statistics

- **Payment items settled through the Automated Clearing Settlement System (ACSS)**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Volume</strong></td>
<td>467,054,748</td>
<td>510,833,402</td>
<td>553,244,377</td>
<td>599,371,256</td>
<td>658,084,133</td>
<td>715,259,219</td>
<td>769,336,925</td>
<td>814,767,640</td>
</tr>
<tr>
<td>Annual Change</td>
<td>-8.6%</td>
<td>-7.7%</td>
<td>-7.7%</td>
<td>-8.9%</td>
<td>-8.0%</td>
<td>-7.0%</td>
<td>-5.6%</td>
<td></td>
</tr>
<tr>
<td>Cumulative Change</td>
<td>-42.7%</td>
<td>-37.3%</td>
<td>-32.1%</td>
<td>-26.4%</td>
<td>-19.2%</td>
<td>-12.2%</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Value ($000)</strong></td>
<td>2,868,976,753</td>
<td>2,947,829,946</td>
<td>3,039,748,141</td>
<td>2,986,314,735</td>
<td>3,035,540,453</td>
<td>2,989,156,268</td>
<td>2,947,635,110</td>
<td>3,002,265,777</td>
</tr>
<tr>
<td>Annual Change</td>
<td>-2.7%</td>
<td>-3.0%</td>
<td>1.8%</td>
<td>-1.6%</td>
<td>1.6%</td>
<td>1.4%</td>
<td>-1.8%</td>
<td></td>
</tr>
<tr>
<td>Cumulative Change</td>
<td>-4.4%</td>
<td>-1.8%</td>
<td>1.2%</td>
<td>-0.5%</td>
<td>1.1%</td>
<td>-0.4%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: These volumes reflect all items processed, including On-Us items which are not cleared to another FI.
Appendix D – Statistics (Cont’d)

• Canadian Payments: Methods and Trends 2020
  

  ▪ On-Us cheque volume 2019 vs 2018 – (-12%)
    ○ Business Cheques (-16%)  Consumer Cheques (-5%)
  
  ▪ Percent of Total Remote Payment Volume
    ○ 2019 = 12% vs 2014 = 27%
  
  ▪ On-Us cheque value 2019 vs 2018 – (-7%)
  
  ▪ Percent of Total Remote Payment Value
    ○ 2019 = 39% vs 2014 = 51%
Thank You

William L. Saffici (Retired)

bill@safficiconsulting.com

610-494-3630