



Combating the Nationwide Escalation of Check Fraud: UCC, Reg CC & ECCHO Rules

Disclaimer

This training series is designed to provide information on various aspects of check payments and the legal and rules framework for electronic check exchange. Responsibility for compliance with electronic check exchange rules, and/or the legal, operational and regulatory requirements applicable to electronic check exchange, remains at all times with the financial institution participating in the exchange and/or the individual or company using an exchange service provider.

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.



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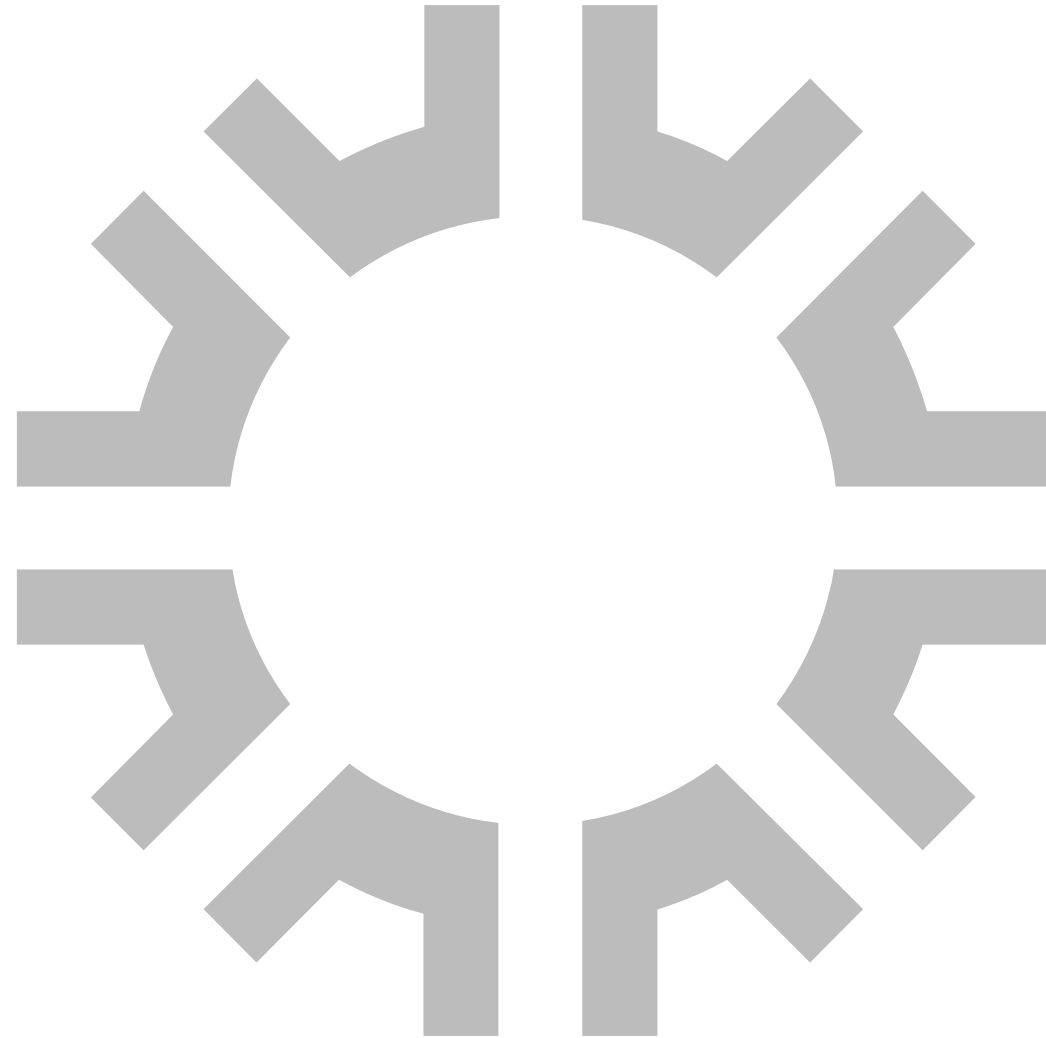
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National Check Professional (NCP) Certification

Check Fraud: A Persistent Threat



Counterfeit Checks/*Forged Maker Checks*

Counterfeit/*Forged Checks*: False checks drawn on valid accounts

- Some security features are not captured by RDC
- "Check cooking" involves fraudsters taking photos of stolen checks and using digital tools to alter information such as the name and the amount.

Common Characteristics

- Poor quality paper stock
- Misspelled printed information
- MICR line missing, skewed, not machine readable
- Fractional RTN different than MICR line
- Check number in wrong position on MICR line
- Forged indorsements

Altered/Forged *Payee* Checks

"Alteration" means (i) an unauthorized change in an instrument that purports to modify in any respect the obligation of a party, or (ii) an unauthorized addition of words or numbers or other change to an incomplete instrument relating to the obligation of a party. UCC §3-407

- **Methods of alteration**
 - Check washing
 - Laser printer
 - Check imprinter
 - Typewriter
 - Handwriting
 - MICR line altered or damaged to delay clearing or return

Remote Deposit Capture (RDC) Fraud

Fraudulent items deposited

- Altered
- Counterfeit/forged
- Indorsement fraud

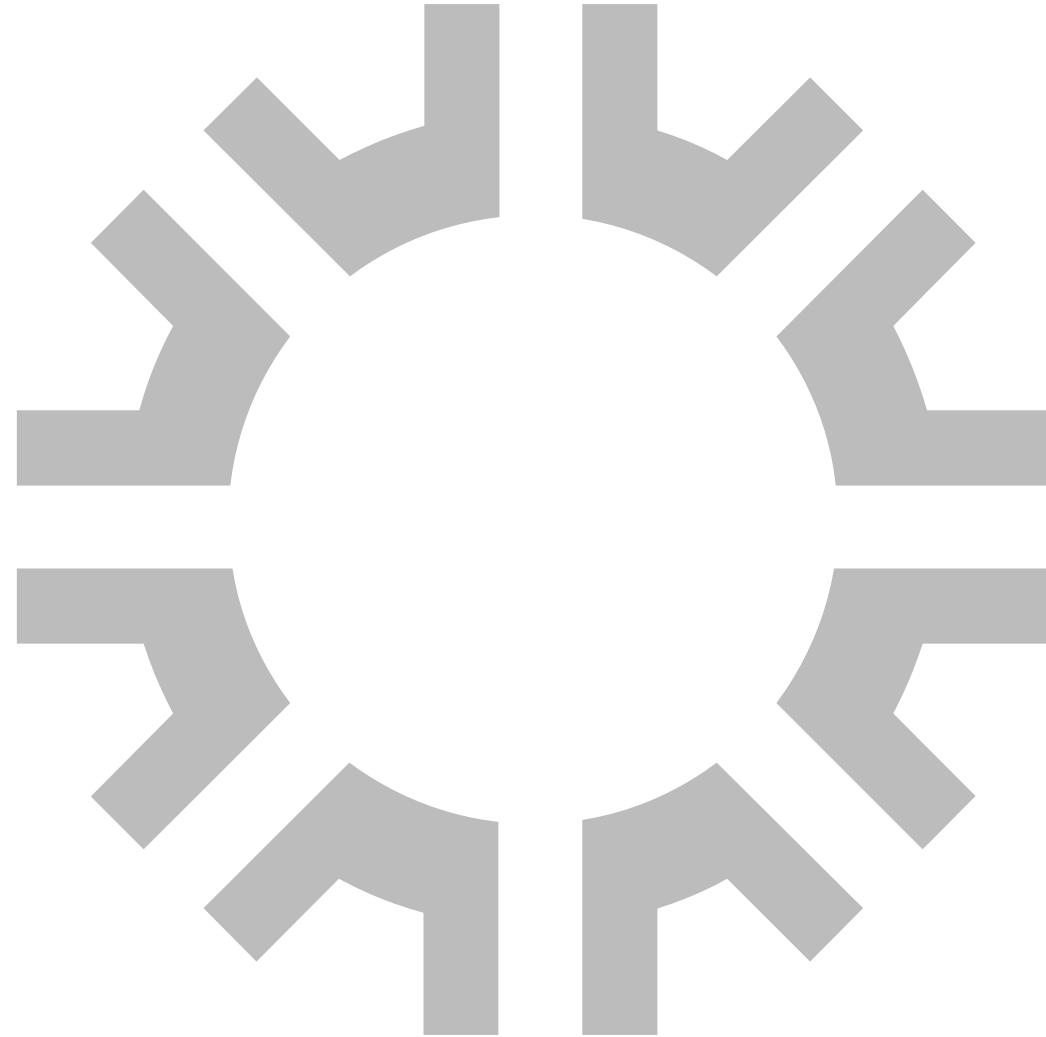
Item deposited more than once

- “Duplicate Warranty” Reg CC

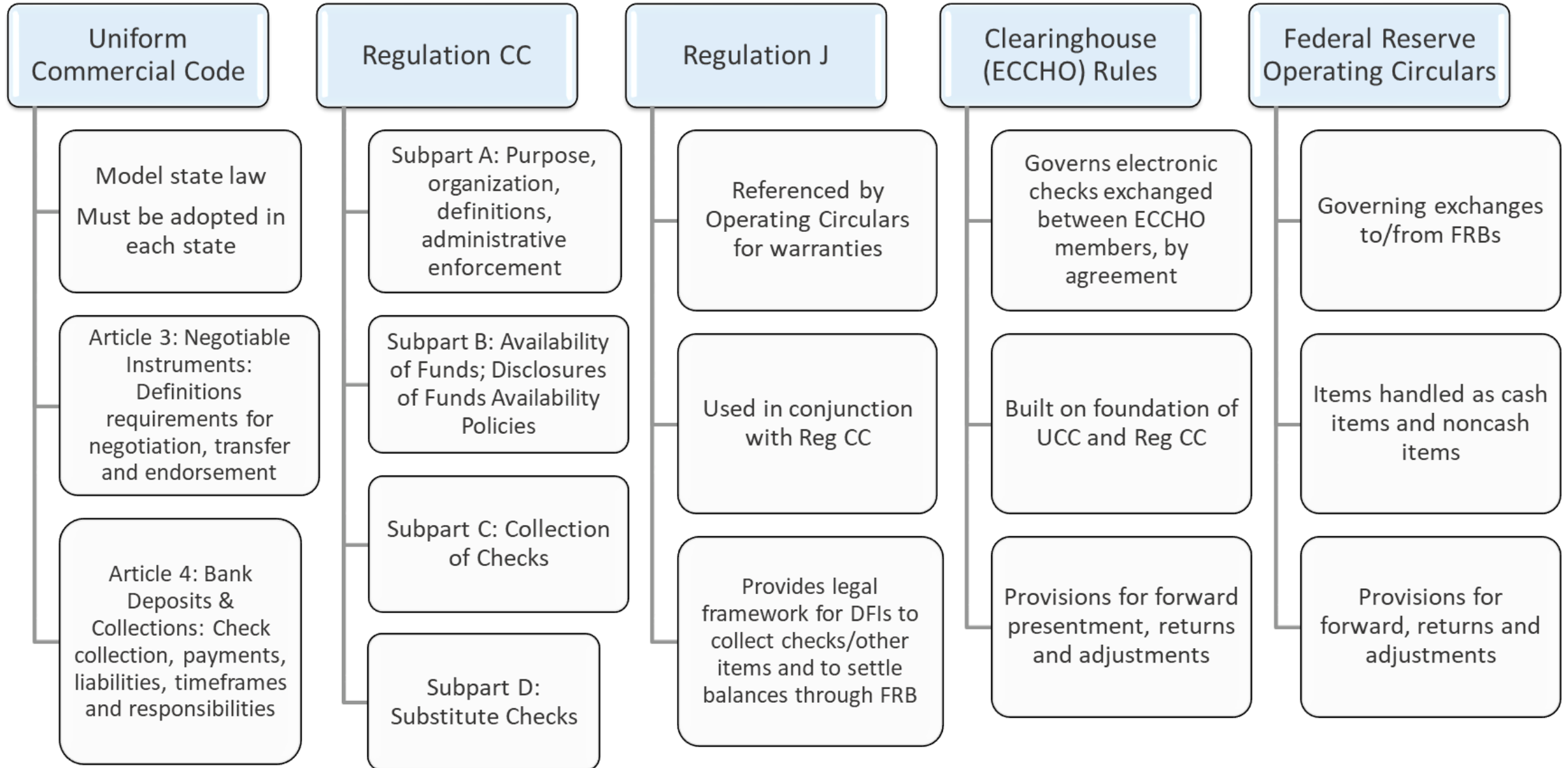
Paper check is negotiated or deposited at another BOFD

- RDC BOFD is a truncating bank under Reg CC but has no control over paper check
- RDC Indemnity Reg CC §229.34(f)

Legal Framework For Check Payments



Interbank Exchange of Checks – Check Governance



UCC Transfer Warranties (UCC §4-207)



(a) A customer or collecting bank that transfers an item and receives a settlement or other consideration warrants to the transferee and to any subsequent collecting bank that:

(1) the warrantor is a person **entitled to enforce the item**;

(2) all **signatures** on the item are **authentic and authorized**;

(3) the item **has not been altered**;

(4) the item is not subject to a defense or claim in recoupment of any party that can be asserted against the warrantor;

(5) the 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; and

(6) with respect to any **remotely-created consumer item**, that the person on whose account the item is drawn **authorized** the issuance of the item in the amount for which the item is drawn.

*UCC §4-207 is similar to the transfer warranties in UCC §3-416.

UCC Presentment Warranties (UCC §4-208)



(a) If an unaccepted draft is presented to the drawee for payment or acceptance and the drawee pays or accepts the draft, (i) the person obtaining payment or acceptance, at the time of presentment, and (ii) a previous transferor of the draft, at the time of transfer, warrant to the drawee that pays or accepts the draft in good faith that:

(1) the warrantor is, or was, at the time the warrantor transferred the draft, a person **entitled to enforce** the draft or authorized to obtain payment or acceptance of the draft on behalf of a person entitled to enforce the draft;

(2) the draft **has not been altered**; and [*sic*]

(3) the warrantor **has no knowledge that the signature** of the purported drawer of the draft is unauthorized; and

(4) with respect to any **remotely-created consumer item**, that the person on whose account the item is drawn **authorized** the issuance of the item in the amount for which the item is drawn.

*UCC §4-208 is substantially similar to the presentment warranties in UCC §3-417.

Regulation C C Warranties & Indemnities (12 CFR §229.34)

§229.34(a) Electronic Check Warranties

- Accurately represents the original check
- No one is asked to pay the same check twice

§229.34(b) Remotely Created Checks are authorized

§229.34(c) Warranty of settlement, encoding and offset

§229.34(d)(e) Return Check and Notice of Nonpayment Warranties

- Paying bank returned or will return check within midnight/Reg CC deadline

§229.34(f)(g) RDC and ECI Indemnities

RDC Indemnity



Protects a **depository bank** that accepts the paper check *without* a restrictive indorsement if it **suffers a loss** due to the check having been already paid

Paying Bank Risk: When Bank May Charge Customer's Account



- (a) A bank may charge against the account of a customer an item that is **properly payable** from that account even though the charge creates an overdraft. An item 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



- (b) A customer is not liable for the amount of an overdraft if the customer neither signed the item nor benefited from the proceeds of the item.



- (c) A bank may charge against the account of a customer a check that is otherwise properly payable from the account, *even though payment was made before the date of the check*, unless the customer has given notice to the bank of the postdating describing the check with reasonable certainty.

Paying Bank Returns: The Clock Is Ticking

UCC Midnight deadline UCC §4-302

- A paying bank has until midnight the banking day following presentment to settle a check
- Pay or return

Regulation CC Expeditious Return requirement Reg CC §229.31(b)

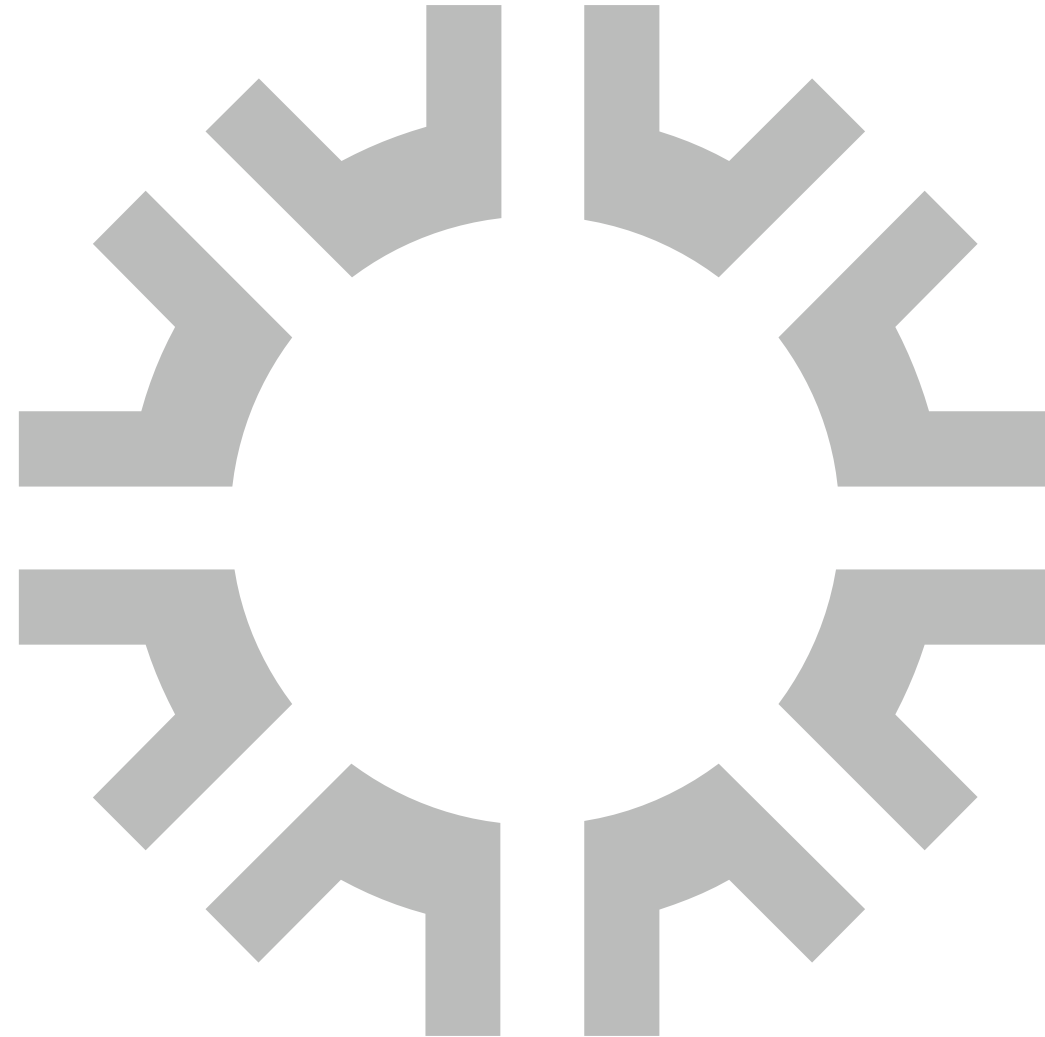
- Return the check in an expeditious manner such that it would normally be received by the depository bank by 2 p.m. (local time of depository bank) on the second business day after the banking day on which it was presented

Reg CC §229.34(d)(2), §229.42 Expeditious return and notice requirements do not apply to:

U.S. Treasury checks, USPS money orders, or checks drawn on a state or unit of government not payable at or through a bank.



Liability – “Who Is On The Hook?”



Warranty Breaches: Who Is At Greatest Risk?

BOFD Presentment Risk

- Indorsement Fraud/Wrong Payee Credited
- Altered Checks
- Duplicates
- Unauthorized Remotely Created Checks
- Encoding Errors

Paying Bank Risk

- Paying Counterfeits/Forgeries
- Late Returns





Who Is On The Hook? - Forged Drawer Signature/ Counterfeit Check

Paying bank may be liable to its accountholder for paying an unauthorized check

- An item 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: When Bank May Charge Customer's Account

Depository bank is not responsible for the loss

- Warrants to paying bank that it has no knowledge that the signature of the purported drawer is unauthorized

*UCC 3 & 4 Transfer and Presentment Warranties
3-year statute of limitation*

Drawer may be liable if they fail to notify their bank

- UCC §4-406 Customer's Duty to discover and report unauthorized signature or alteration

Established by account/deposit agreement



Who Is On The Hook? - Forged Endorsement/Alteration



Paying bank may be liable to its accountholder for paying an unauthorized check

- Based on account/deposit agreement

UCC §4-401 When Bank May Charge Customer's Account



Depository bank is responsible for the loss

- Warrants it's entitled to enforce the item & all signatures on the item are authentic and authorized

UCC 3 & 4 Transfer and Presentment Warranties - 3-year statute of limitation



Depositor may be liable to depository bank for damages arising from a fraudulently indorsed check

- Established by account/deposit agreement
Depositor may be liable under the transfer and presentment warranties in addition to account/deposit agreement



When The Customer Is Liable – (UCC §4-406)



Customers are generally liable for check fraud if they . . .



Fail to review bank statements within 30-60 days (Review deposit agreement)



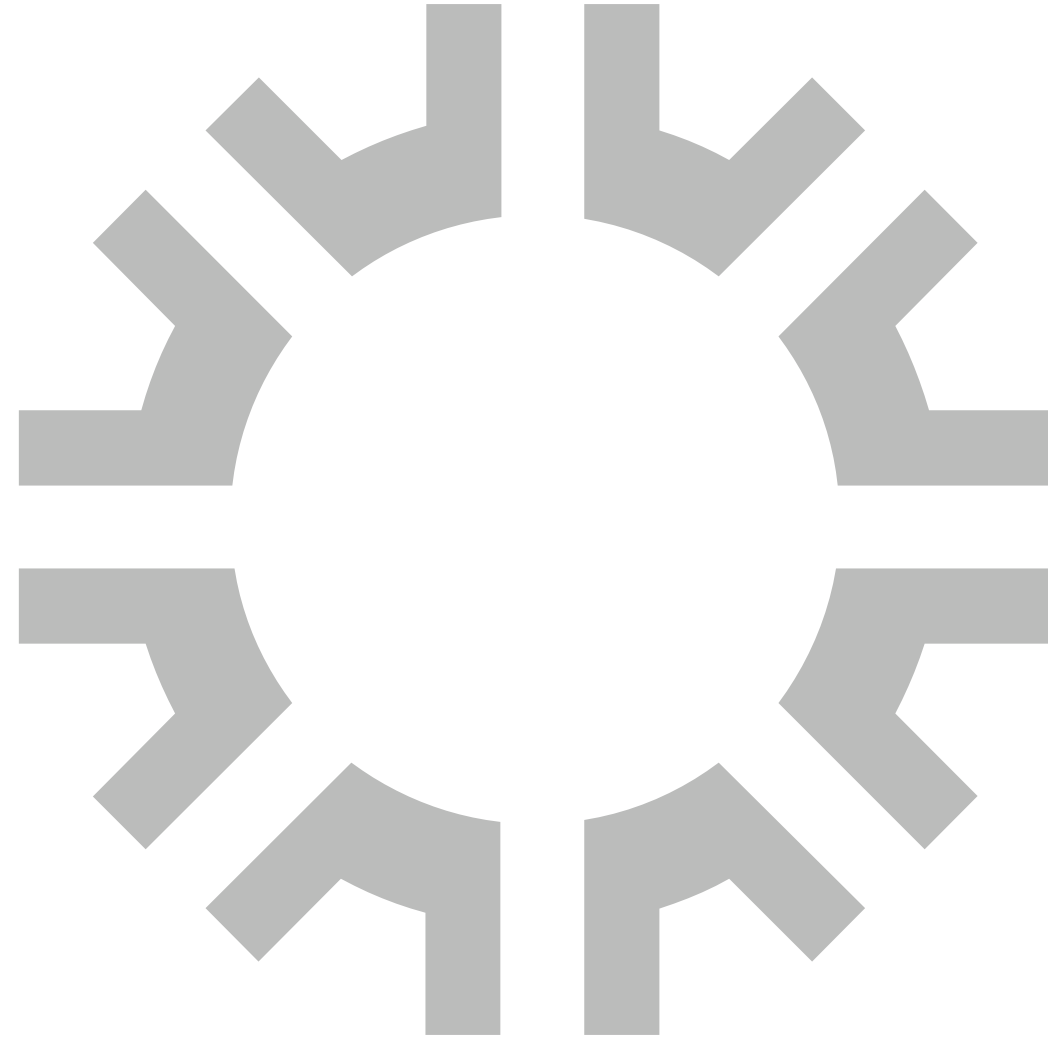
Negligently handle checkbooks, or



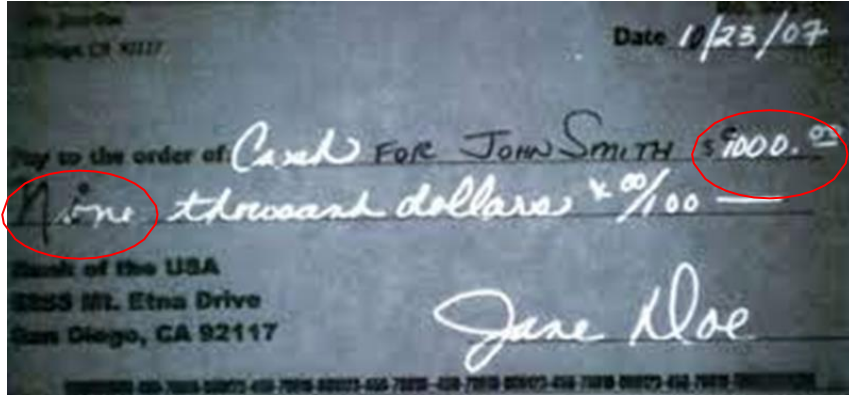
Sign blank checks



Check Fraud & Risk Mitigation



Spotting Check Fraud – Altered Checks



Issued checks stolen from mailboxes, offices, etc.?

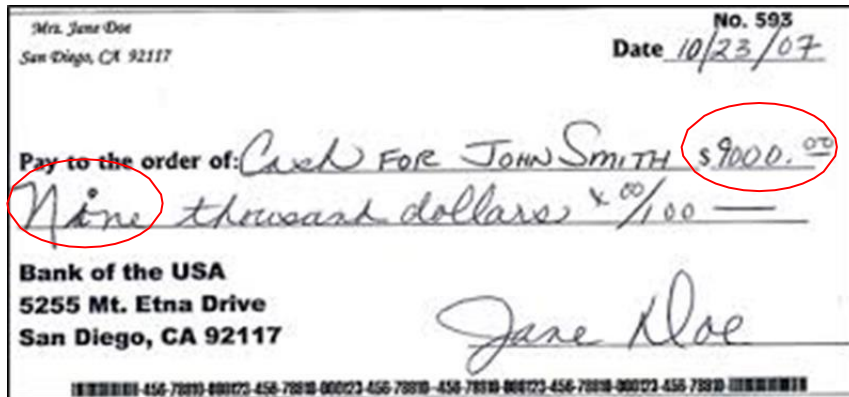
Payee name, dollar amount, legal amount changed?

Name typed above a business name on an issued check?

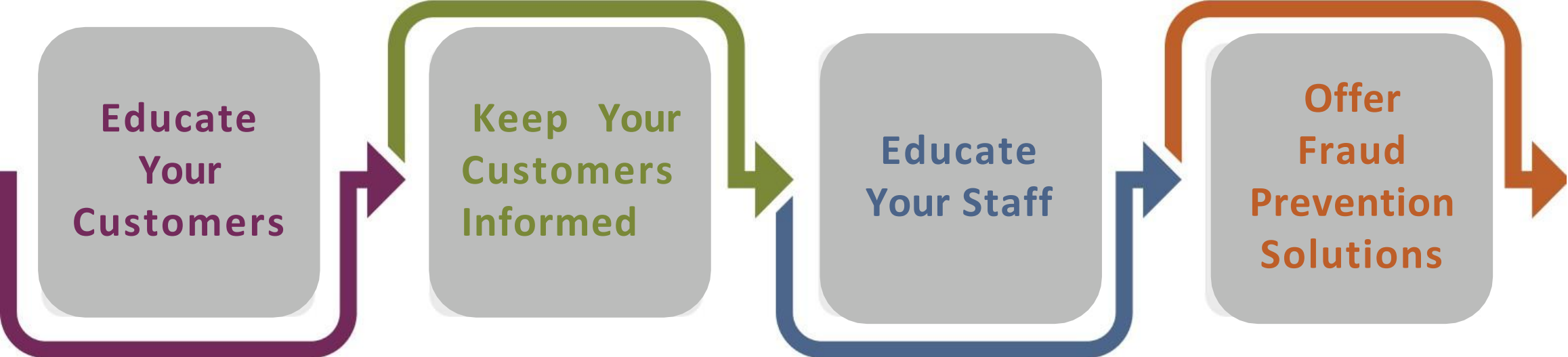
Does handwriting of payee and maker's signature match?

Is the font consistent with previous checks?

Does the payment history support the check being presented?



Preventing Check Fraud



RDC Operational Control Considerations



Daily dollar limits on deposit

- Dollar limit on item

Consider restrictions on types of items eligible for RDC

- Substitute checks
- Cashier's checks
- Treasury checks

Review new account activity

Indorsement review

- Restrictive indorsement required?

Monitor NSF/chargeback/PAID adjustment activity

- Establish and enforce acceptable thresholds

BOFD: How Can I Verify A U.S. Treasury Check?



Treasury Check Verification System

- <https://tcvs.fiscal.treasury.gov>

US Treasury Check Security Features

- [Fiscal.treasury.gov/files/reference-guidance/gold-book/check-security-features.pdf](https://fiscal.treasury.gov/files/reference-guidance/gold-book/check-security-features.pdf)

FedDetect Duplicate Treasury Check Notifier Service

- www.frbservices.org/financial-services/check/feddetect

BOFD: Verify U.S.P.S. Money Orders



Visit website for tips on identifying counterfeit money orders



https://about.usps.com/postal-bulletin/2018/pb22487/html/mo_003.htm

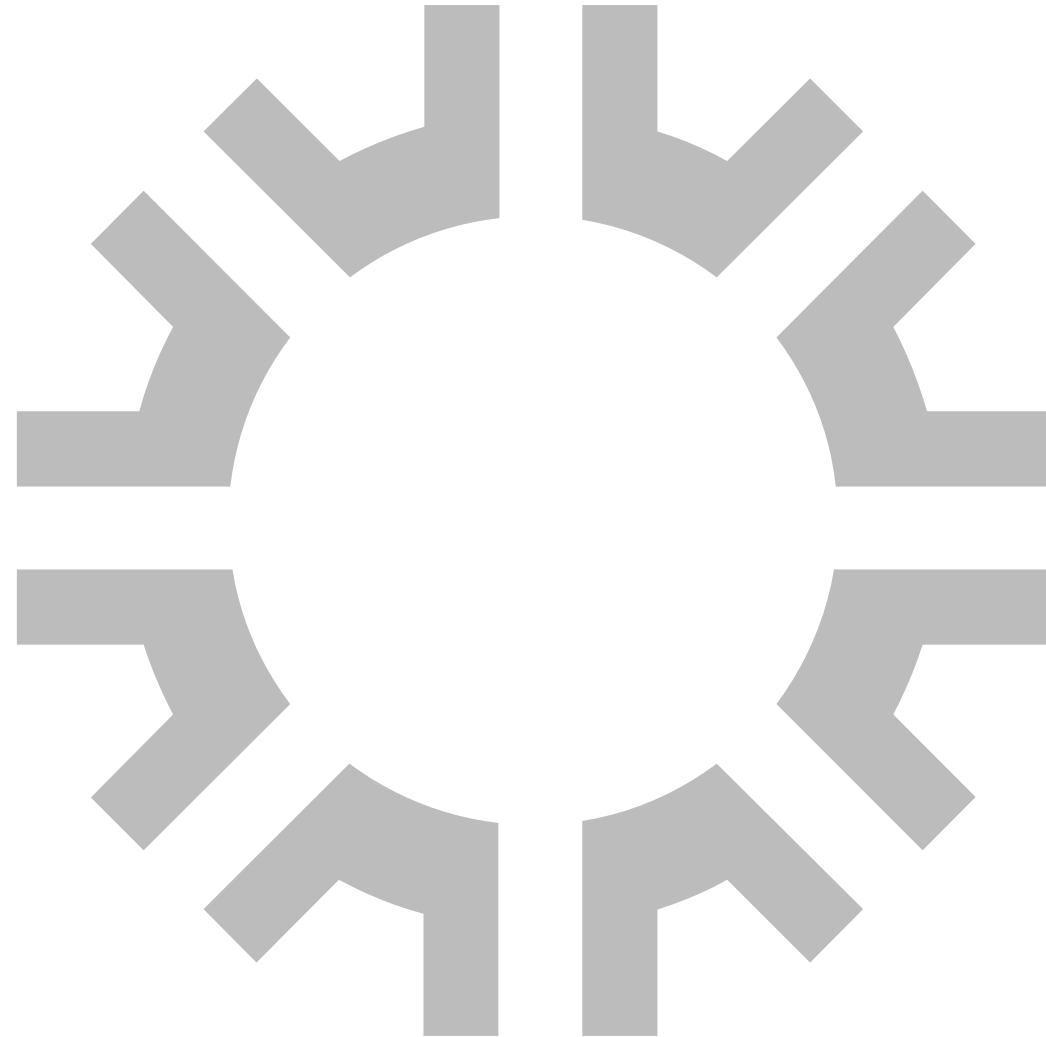


Maximum dollar amount is \$1000; any amount above this is a good indicator of a fraudulent item



Call U.S.P.S. money order verification system at 866-459-7822

ECCHO: Rule 8 & 9



Rule 8



Remotely Created Check (RCC)

- Defined in Reg CC as a check that is
 - Not created by paying bank; and
 - Does not bear signature applied or purported to be applied, by the person on whose account the check is drawn
- RCCs are unsigned drafts

Warranty Reg CC §229.34(b)

- Bank that transfers or presents a remotely created check and receives a settlement or other consideration warrants that:
 - Person on whose account the remotely created check is drawn authorized issuance of the check:
 - ✓ in the amount stated on the check, and to the payee stated on the check

Note: Moves liability from paying bank to bank that transfers or presents the RCC for payment

Rule 9



What: Purpose of Rule 9 is to handle forged and counterfeit items recognized by a bank customer after midnight deadlines

- Rule 9 provides paying bank an avenue of recourse

Who: Rule 9 is available only for check images exchanged among ECCHO members

- As long as neither member has opted out of Rule 9

Why: Rule 9 shifts liability for unauthorized item to BOFD and ultimately its depositing customer

- Rule 9 places liability on BOFD, which may by agreement pass the loss to its depositing customer

National Check Payments Certification



National Check Payments Certification (NCP)



**Become a Check Professional
and Be Recognized**

- Premier accreditation
- Expert level check payment acumen
- Comprehensive understanding of check processing, image exchange rules, and regulatory requirements (UCC Articles 3 & 4, Federal Regulation CC & ECCHO Rules)
- For full details go to, “Step 4: Score” on this webpage [Considering NCP](#)

Questions

The Clearing House
Membership Services & Education
800.875.2242, Option #5
education.services@theclearinghouse.org



Fighting Fraud Together: Combating the Nationwide Escalation of Check Fraud



Regulations, Rules and Agreements

Uniform Commercial Code

- Model law as adopted in each state
- Definition of negotiable instruments
- Transfer and presentment warranties for bank deposits and collections
- Applies to provisions of bank-to-customer agreements; addresses RDC deposit / payment / customer relationship

Reg CC

- Federal law – applies to availability of funds and collection of checks
- Definitions extend Reg CC warranties to image of check
- Subpart C applies to interbank exchange of electronic checks / electronic returned checks
- Subpart D applies to the substitute check

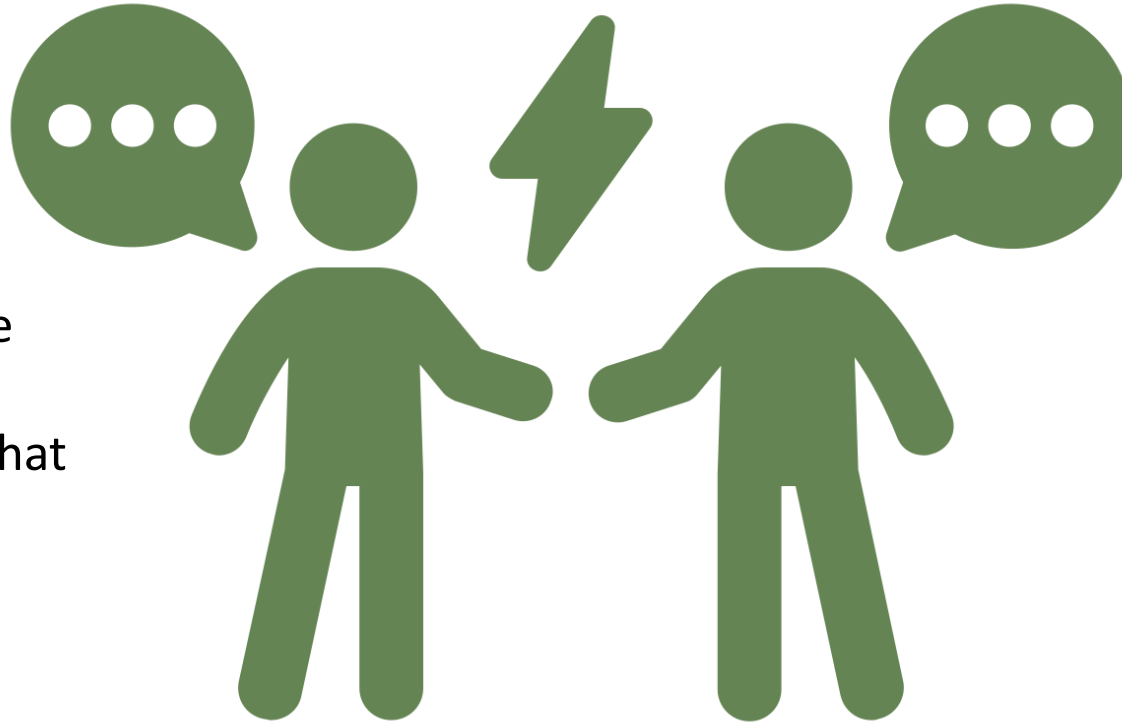
Rules & Agreements

- ECCHO Operating Rules and Federal Reserve Operating Circular 3 (OC3)
- Define terms of exchange (what, where, when):
 - Eligible items and rules for certain types of checks
 - Define adjustments and operational processes, including settlement
 - Provide exceptions or variations to regulatory provisions



Regulations define which financial institution is responsible for the transfer and presentment warranties

The bank of first deposit (BOFD) warrants that the correct account holder received the funds and that the check has not been altered.



The paying bank warrants that the check is properly payable (authorized, correct amount, etc.).

A noticeable shift has occurred in the past few years, placing greater scrutiny on the paying bank to prove the check was properly payable. Financial institutions are using different tactics to deny claims.



Uniform Commercial Code defines when a member may be charged and the check return deadline

§ 4-401. WHEN BANK MAY CHARGE CUSTOMER'S ACCOUNT.

(a) A bank may charge against the account of a customer an item that is properly payable from that account even though the charge creates an overdraft. An item is properly payable if it is authorized by the customer and is in accordance with any agreement between the customer and bank.

(b) A customer is not liable for the amount of an overdraft if the customer neither signed the item nor benefited from the proceeds of the item.

An item is **properly payable** if it is authorized by the customer.

§ 4-214. RIGHT OF CHARGE-BACK OR REFUND; LIABILITY OF COLLECTING BANK; RETURN OF ITEM.

(a) If a collecting bank has made provisional settlement with its customer for an item and fails by reason of dishonor, suspension of payments by a bank, or otherwise to receive settlement for the item which is or becomes final, the bank may revoke the settlement given by it, charge back the amount of any credit given for the item to its customer's account, or obtain refund from its customer, whether or not it is able to return the item, if by its midnight deadline or within a longer reasonable time after it learns the facts it returns the item or sends notification of the facts. If the return or notice is delayed beyond the bank's midnight deadline or a longer reasonable time after it learns the facts, the bank may revoke the settlement, charge back the credit, or obtain refund from its customer, but it is liable for any loss resulting from the delay. These rights to revoke, charge back, and obtain refund terminate if and when a settlement for the item received by the bank is or becomes final.

An item must be returned by the drawn-on financial institution by the midnight deadline on the day following presentment for guaranteed funds.



What do I do if a member reports a check after the return deadline?



Review the situation thoroughly to determine if the item is a counterfeit item, unauthorized remotely created check or altered.



If truly counterfeit, review your member agreements to ensure that the check was reported within your allowed timeframe.



In most cases, the member will need to be credited back.



Seek assistance from your compliance team, legal advisor and/or association on next steps.

Steps may include:

- Rule 9 Claim if both FIs are ECCHO members or
- Submitting a hold harmless request directly to the bank of first deposit



Uniform Commercial Code also defines the presentment warranties that a bank of first deposit makes

§ 4-208. PRESENTMENT WARRANTIES.

(a) If an unaccepted draft is presented to the drawee for payment or acceptance and the drawee pays or accepts the draft, (i) the person obtaining payment or acceptance, at the time of presentment, and (ii) a previous transferor of the draft, at the time of transfer, warrant to the drawee that pays or accepts the draft in good faith that:

(1) the warrantor is, or was, at the time the warrantor transferred the draft, a person entitled to enforce the draft or authorized to obtain payment or acceptance of the draft on behalf of a person entitled to enforce the draft;

(2) the draft has not been altered; and

(3) the warrantor has no knowledge that the signature of the purported drawer of the draft is unauthorized; and

(4) with respect to any remotely-created consumer item, that the person on whose account the item is drawn authorized the issuance of the item in the amount for which the item is drawn.

(b) A drawee making payment may recover from a warrantor damages for breach of warranty equal to the amount paid by the drawee less the amount the drawee received or is entitled to receive from the drawer because of the payment. In addition, the drawee is entitled to compensation for expenses and loss of interest resulting from the breach. The right of the drawee to recover damages under this subsection is not affected by any failure of the drawee to exercise ordinary care in making payment. If the drawee accepts the draft (i) breach of warranty is a defense to the obligation of the acceptor, and (ii) if the acceptor makes payment with respect to the draft, the acceptor is entitled to recover from a warrantor for breach of warranty the amounts stated in this subsection.

BOFD warrants that an item was not altered, the correct payee received credit and that a remotely created check was authorized.



There are five warranty breach categories that Alloya can assist with

Altered

Payee and/or dollar amount is fraudulently altered.

Indorsement

Intended payee on check does not receive funds. Check is not properly indorsed by payee (missing, forged, etc.).

Late return

Check was not returned within the 24-hour window from the time it was presented to the FI.

RDC Indemnity

Allows the BOFD with possession of the paper check to hold the remote depositing FI liable for not securing the item.

URCC

Unauthorized Remotely Created Checks do not bear the maker's signature and are created by the payee.



Documentation is stored within Alloya's Premier View Help Center

The screenshot shows the Alloya Premier View interface. The top navigation bar includes the Alloya logo, the account name "Alloya Corporate FCU" with ID "271987635", and a Help Center icon. A dropdown menu is open from the Help Center icon, listing "Help Center", "Live Training & Events", and "Recorded Training". The main content area features "Discover Alloya's Solutions" with tiles for Payments, Liquidity, Investments, and Member Solutions. Below this are sections for "Account Balances" (Shares, Loans, Certificates, Today's Rates, Transfer) and "Pending Activities" (Transactions, Acknowledgements, Templates). A "FastTrack" sidebar is visible on the left.

The screenshot shows the "Check Clearing Services" help page. It is organized into three columns: "FAQS", "OPERATIONS MANUALS AND GUIDES", and "FORMS".

- FAQS**
 - ▶ Check Return Reasons
 - ▶ How do I make a check warranty claim on a forged or altered inclearing check?
 - ▶ TranZact Item Processing Cutoff and Availability Times
 - ▶ TranZact Item Processing Tip Sheet
 - ▶ Warranty Breach Claims Best Practices
 - ▶ What descriptions are used on credit and debit adjustments?
- OPERATIONS MANUALS AND GUIDES**
 - ▶ **Training Videos**
 - ▶ Exporting Check Data to an Excel Spreadsheet
 - ▶ Member Checking Operating Manual
 - ▶ Positive Pay for Credit Union Checks Implementation
 - ▶ Positive Pay Operating Manual
 - ▶ Printing Member Checking Images
 - ▶ Requesting a Source of Receipt
- FORMS**
 - ▶ Hold Harmless Sample - Uniform Indemnity Agreement
 - ▶ **Warranty Claim Affidavit**



Risk Mitigation



Education for credit union staff

Alloya offers free monthly training:
<https://www.alloyacorp.org/education-events/online-education-training/>

ECCHO membership:

<https://www.alloyacorp.org/eccho/>

National Check Professional accreditation:

<https://www.theclearinghouse.org/payments-services/Payments-Accreditations>



Education for the credit union's members

Encourage members to review their accounts via the home banking app and report discrepancies immediately.

- Time is of the essence! The sooner discrepancies are reported, the better chance the credit union has of reclaiming funds.

Encourage electronic payments, ACH transfers, real-time payments, card transactions, etc.

If they must issue a check, do not put it in the mail.



Credit unions should review internal procedures & policies

Pick a dollar amount and visually review items that exceed that amount for anomalies.

Credit union checks have seen a massive increase in alterations.

- Balance checks daily and make sure the payee matches to who the check was issued to.



Don't always be the nice guy

Remote deposit capabilities are earned and are not a right.

- Establish maximum deposit amounts daily, weekly and monthly.
- New members should have to exhibit good behavior before receiving RDC access.
- If behaviors change (increased NSF's, negative balance, etc.), adjust access accordingly.
- Review check hold policy and member disclosures with an attorney versed in check law.



Questions?

If you have any questions, please contact your Alloya representative or our Member Services team.

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