

# Regulation CC



Tiller Endeavors, LLC

*To Steer the Course You Need a Tiller!*

**COCC Conference  
Southington, CT  
September 28, 2018**

# NOTICE

*Nothing in these comments should be understood as legal advice!*

*I am not an attorney and I am not providing legal advice!*

*Should you or your company require legal counsel, you should consult with a competent attorney!*

*The opinions expressed here are mine unless otherwise noted!*

# Credits / Recognitions

- **Phyllis Meyerson**

- Phyllis contributed significantly to the contents of this presentation
- She is a friend, collaborator, professional associate and a recognized industry expert
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- **TCH/ECCHO**

- Some of the materials are derived from third party materials attributed to TCH/ECCHO

# Topical Agenda

- **Who is Tiller Endeavors?**
- **Regulation CC**
  - Subparts A, B, C & D
  - New Reg CC Warranties
  - ECIs – Reg CC and Reg J
  - New RDC Indemnification
  - Restrictive Endorsements
  - RDC Duplicate Scenarios
  - New Presumption of Altered vs. Counterfeit Items
- **Attachments**

# Who Is Tiller Endeavors?

- **New Consulting Company**

- Formed when ECCHO sold its assets to The Clearinghouse
- My relationship with ECCHO – ended after 27 years
  - ✓ Formerly the President & CEO for 17 years

- **Why Tiller Endeavors?**

- Is this about gardening?
- Tiller is also a sailing term and a tiller is used in steering the boat
- *“To steer the course you need a Tiller!”*

# Regulation CC

## • Overview

- Fed issued Requests for Comment on changes to Regulation CC in 2011 and 2014
  - ✓ Fed amended Subparts C and D of Regulation CC to facilitate banking industry's ongoing transition to fully-electronic check collection and return process
- Final Rule Issued May 31, 2017
  - ✓ Took effect on July 1, 2018
  - ✓ Final Rule can be found at
    - <https://www.gpo.gov/fdsys/pkg/FR-2017-06-15/pdf/2017-11379.pdf>
- After July 1, 2018, issued final rule on presumption of alteration for certain disputes
  - ✓ Effective January 1, 2019 – No implementation requirements
- Proposed revisions to Subpart B remain outstanding
  - ✓ Joint authority with Fed and CFPB over Subpart B

# Regulation CC

- **New/Revised Reg CC Addresses:**

- Added definitions and coverages for Electronic Check and Electronic Returned Check
  - ✓ Images derived from original paper checks
  - ✓ Forward collection and unpaid returns
- Creates new warranties under Regulation for Electronic Checks
  - ✓ No duplicate payments
  - ✓ Information accurately represents all of the information from front and back of paper check
  - ✓ Information contains accurate record of all MICR line information
  - ✓ Warranties are made to all parties in collection/ presentment/ return chain including banks and persons:
    - Drawer customer on forward collection and
    - Depositing customer/payee on return
- Expeditious returns
  - ✓ Shifts liability from paying bank to BOFD in certain scenarios
    - Applies to paper checks and electronic checks

# New Expeditious Return Rule

- **Limits on Paying Bank Liability**

- No liability for failure of expeditious return for certain arrangements

- ✓ Encourages depository bank to accept Electronic Returned Checks
- ✓ Provides liability protection if depository bank does not have appropriate electronic connection
- ✓ Depository bank must have arrangements for electronic return of checks by “commercially reasonable” means
  - ***Burden of proof on depository bank***

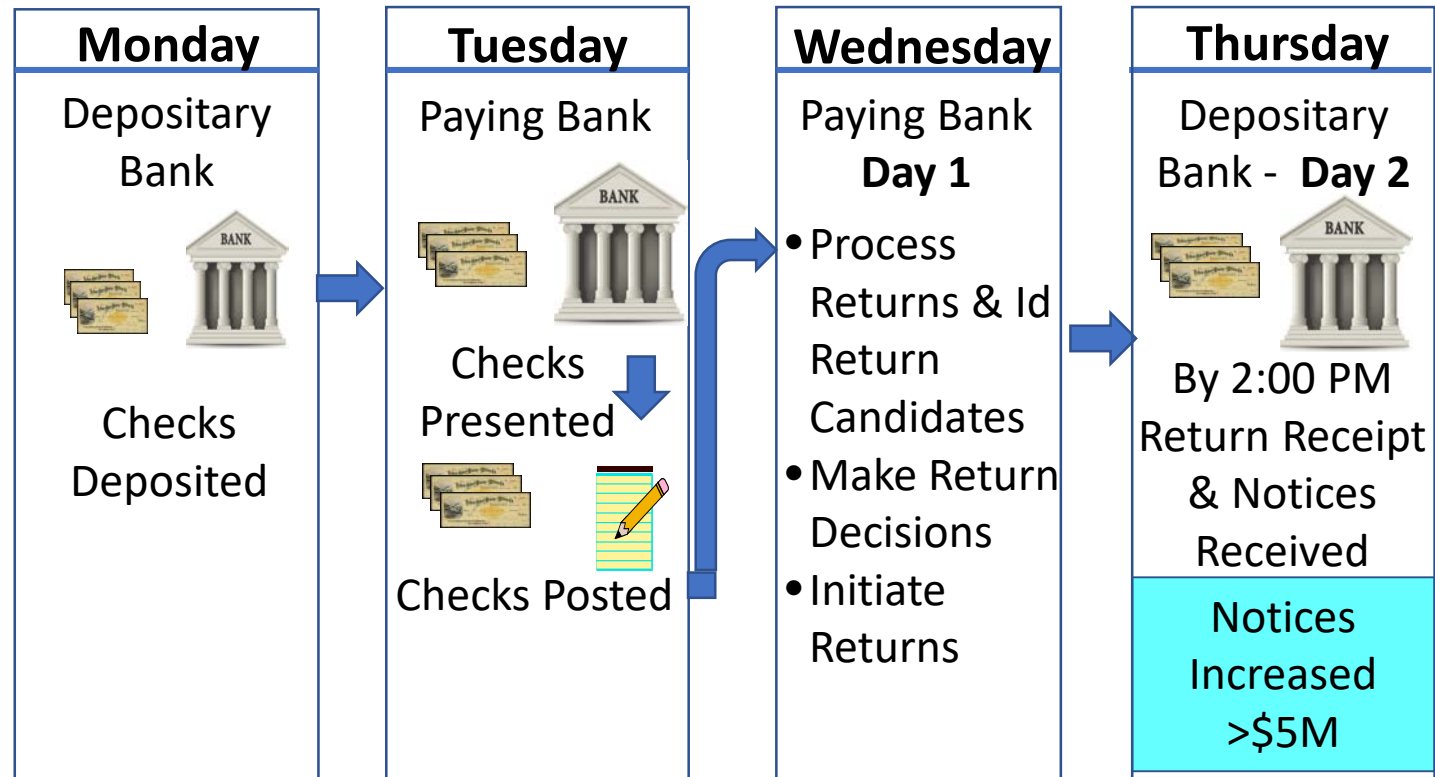


# Regulation CC

- **New/Revised Reg CC Addresses:**

- **Modified Version of Current Test**

- ✓ Requires all returned checks, both paper and electronic, to satisfy modified version of current “two-day test” for expeditious return

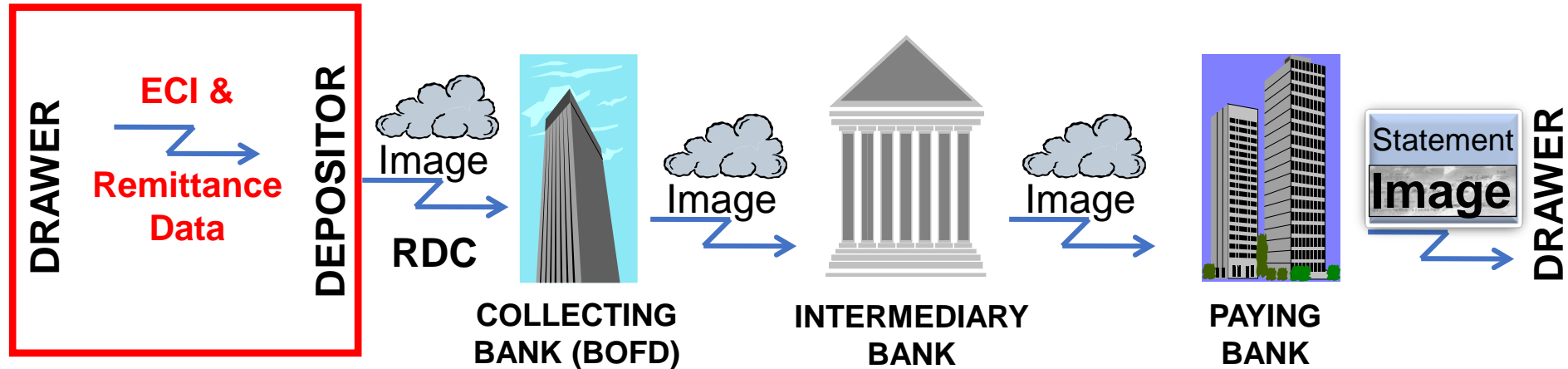


# Electronically Created Item

- **New Indemnities for Electronically Created Items (ECIs) Covers Losses Caused by:**
  - ECIs not derived from a paper check
  - ECIs not authorized by account holder
  - Subsequent bank pays an item already paid
- **Other Risk Considerations**
  - Could include Reg E losses incurred by paying bank
  - Indemnity shifts losses to depository bank
  - ECI is not an “electronic check” under Final Rule
    - ✓ ECIs not eligible for image exchange under check rules
  - Not subject to other provisions of Reg CC
    - ✓ For example, expeditious return times
- **Loss Recovery Limited**
  - To amount of settlement plus interest and expenses of indemnified bank
    - ✓ Does not include consequential damages

# Electronically Created Item

- What is an ECI?



- Electronic Image that has all attributes of electronic check/electronic returned check but was created electronically and not derived from paper check
  - ✓ Also known as: Electronic Payment Order (EPO)
- Never existed in paper form and does not meet Reg CC definition of electronic check
  - ✓ ECI cannot be used to create substitute check that is legal equivalent

# Regulation J & Reg CC

- **What is Reg J?**

- Covers check and Fedwire services offered by Reserve Banks
  - ✓ Does not cover private sector check exchanges

- **Reg J Needs to Be in Sync with Reg CC**

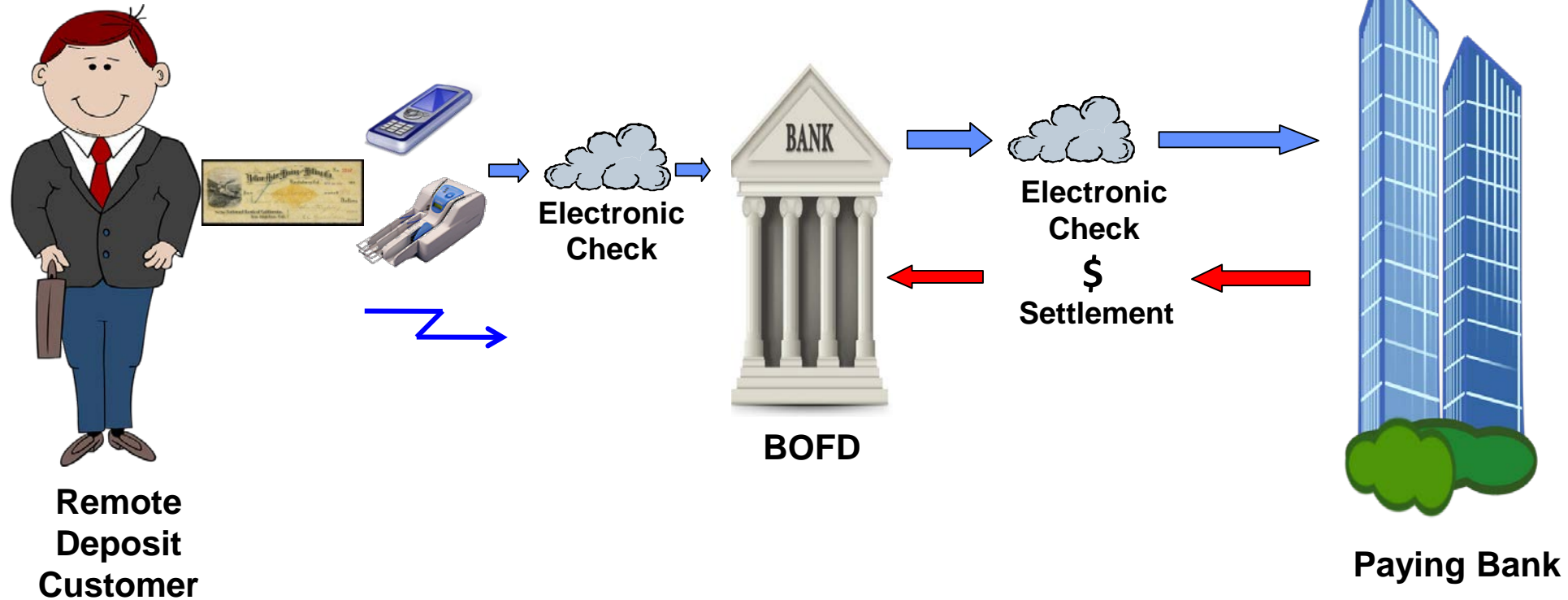
- New Reg CC provisions necessitate changes in Reg J

- **Fed Issued an RFC on Proposed Changes to Reg J**

- In addition to conforming changes between Regs J & CC, Fed proposed a prohibition on ECIs in Reg J
- Received 24 comment letters with 54 named responders plus 3 anonymous
- 47 of 57 or 82.5% opposed Fed's proposal
- For more information please visit <https://tillerendeavors.com/>

# Remote Deposit Capture

- What is Remote Deposit Capture?

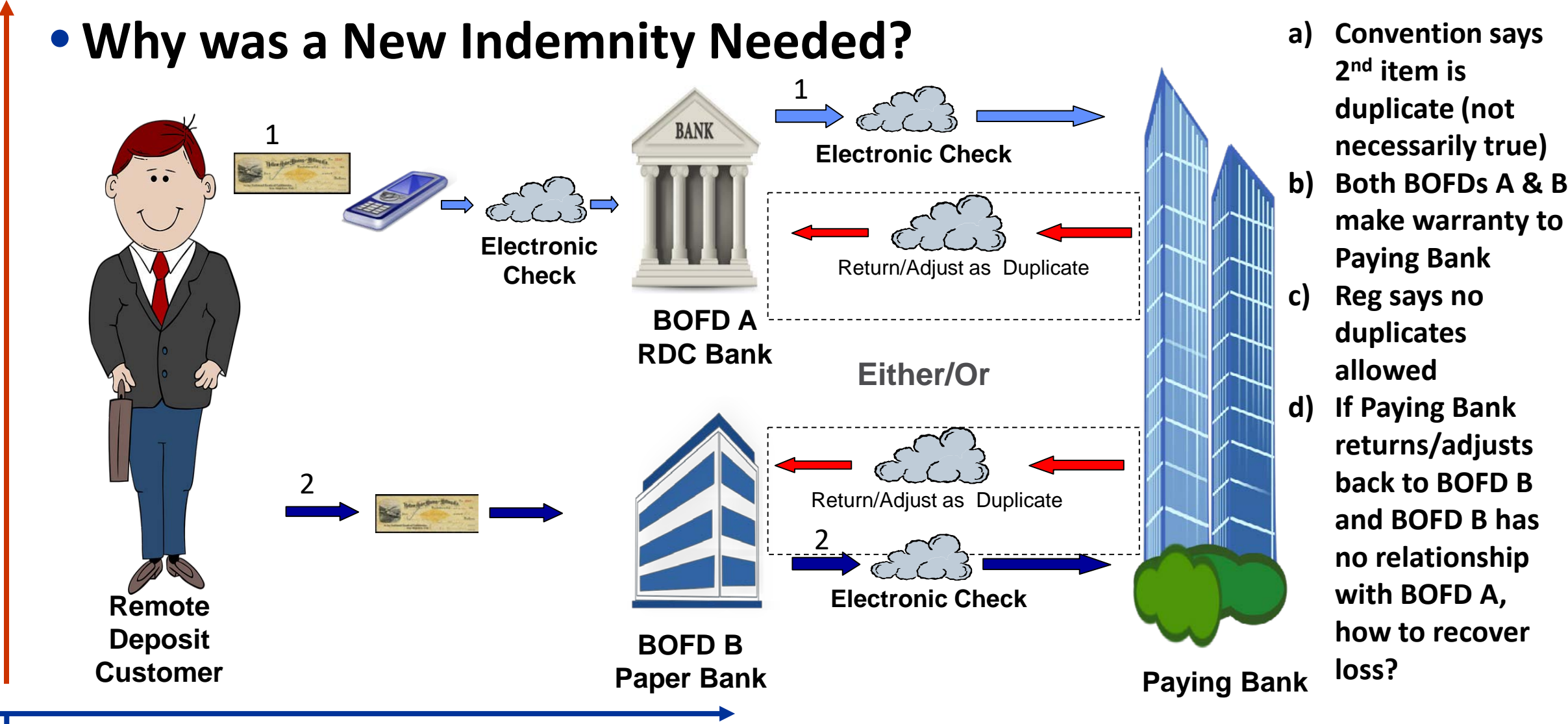


# RDC Indemnity

- **New Indemnity Added to Amended Reg CC**
- **Purpose of Indemnity:**
  - Provides some protection to subsequent depository bank that receives deposit of *paper check*
  - RDC bank's potential liability arises when it permits customer to truncate check and deposit image of that check
- **Paying Bank's Duplicate Item Decisioning Process Remains Unchanged**
  - May return duplicate if timing permits
  - May adjust as a PAID or Duplicate adjustment type
  - May send return/adjustment *to either BOFD*

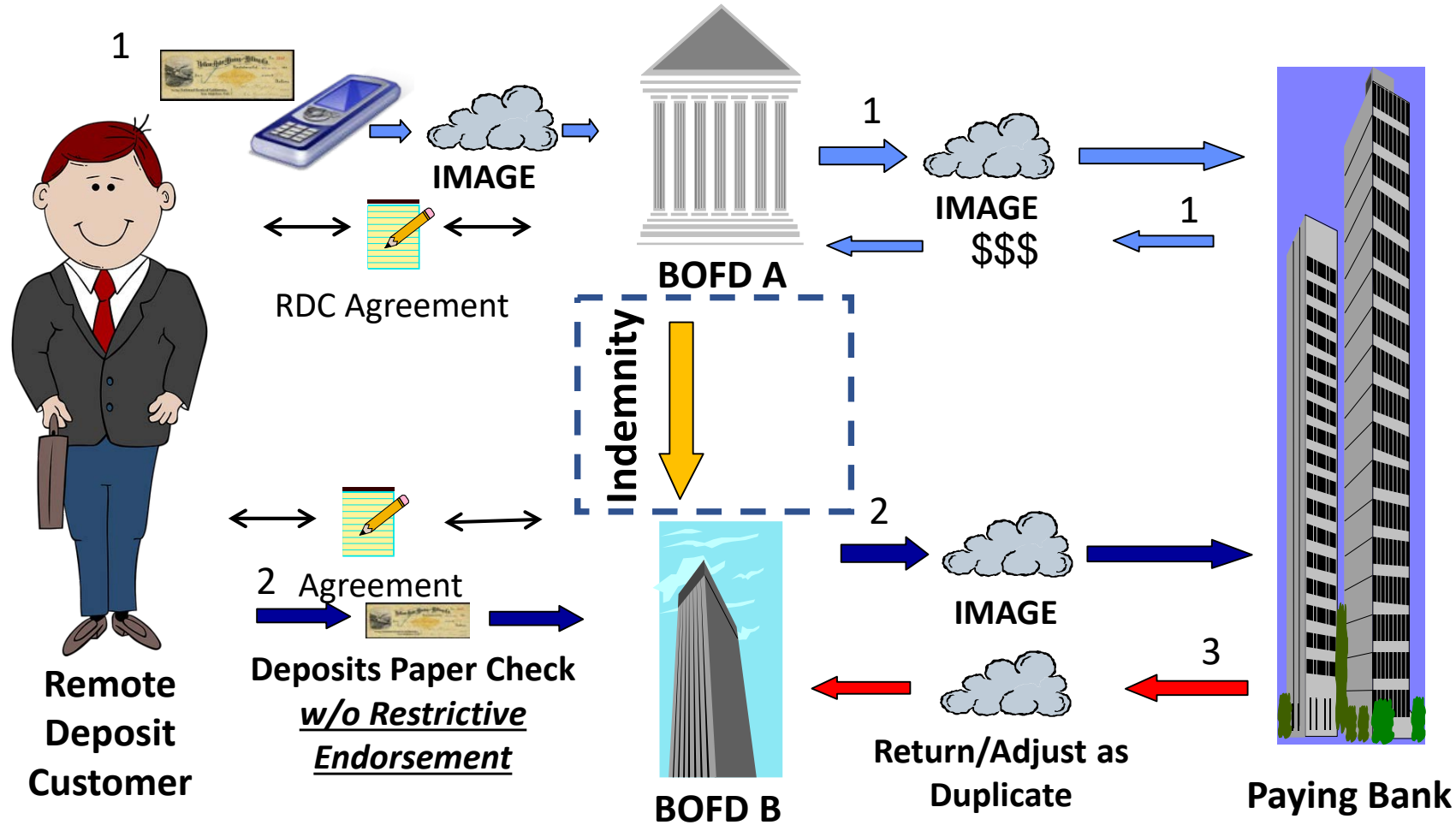
# Reg CC – New RDC Indemnity

- Why was a New Indemnity Needed?



# Reg CC – New RDC Indemnity

## • When Does BOFD Make the Indemnification?

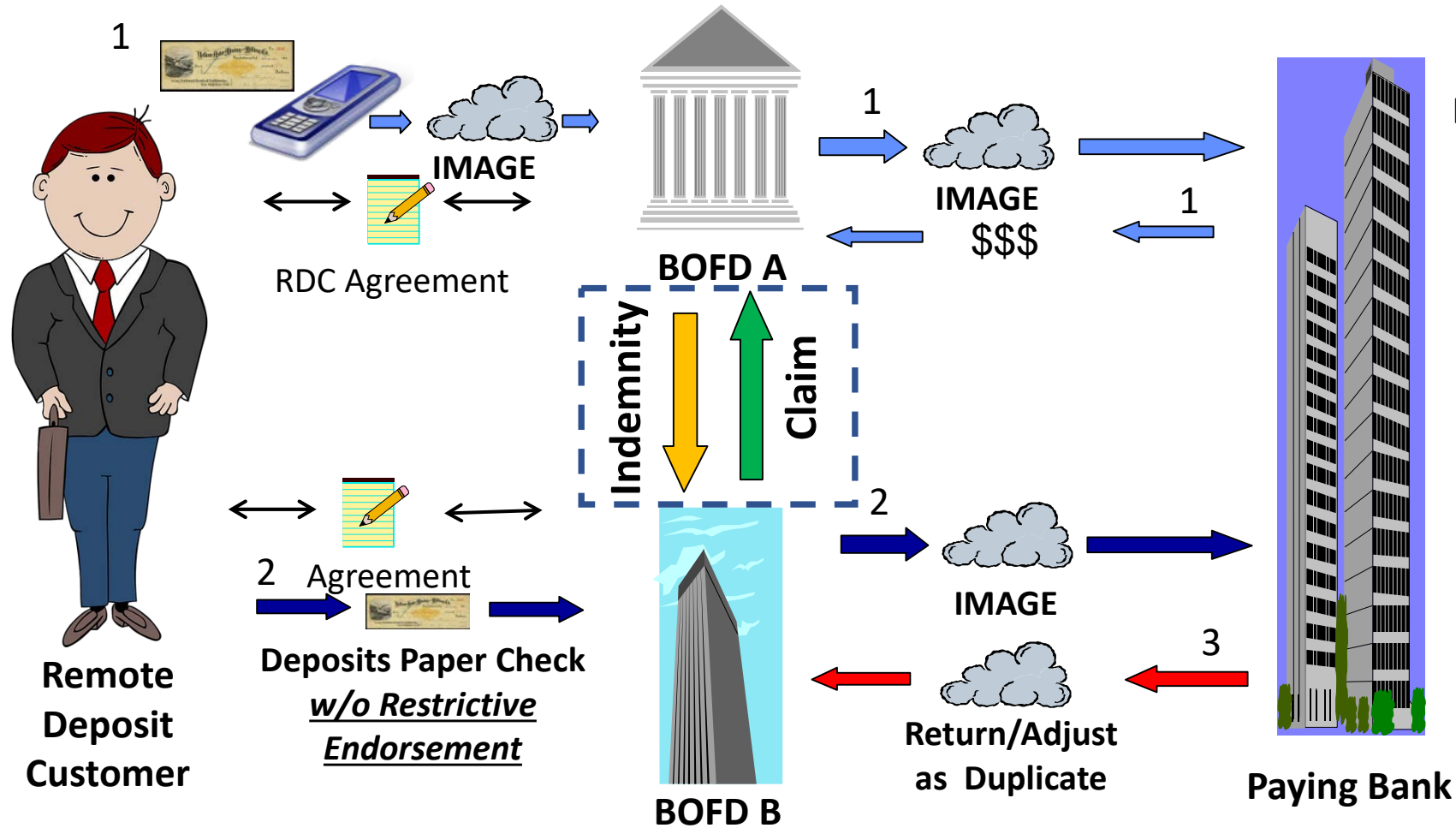


- New indemnity made when:**
- 1) BOFD A is a truncating bank; **and**
  - 2) BOFD A does not receive an original check; **and**
  - 3) BOFD A receives settlement; **and**
  - 4) BOFD A does not receive return of check unpaid



# Reg CC - New RDC Indemnity

## • When Can BOFD B Enforce the Indemnity?

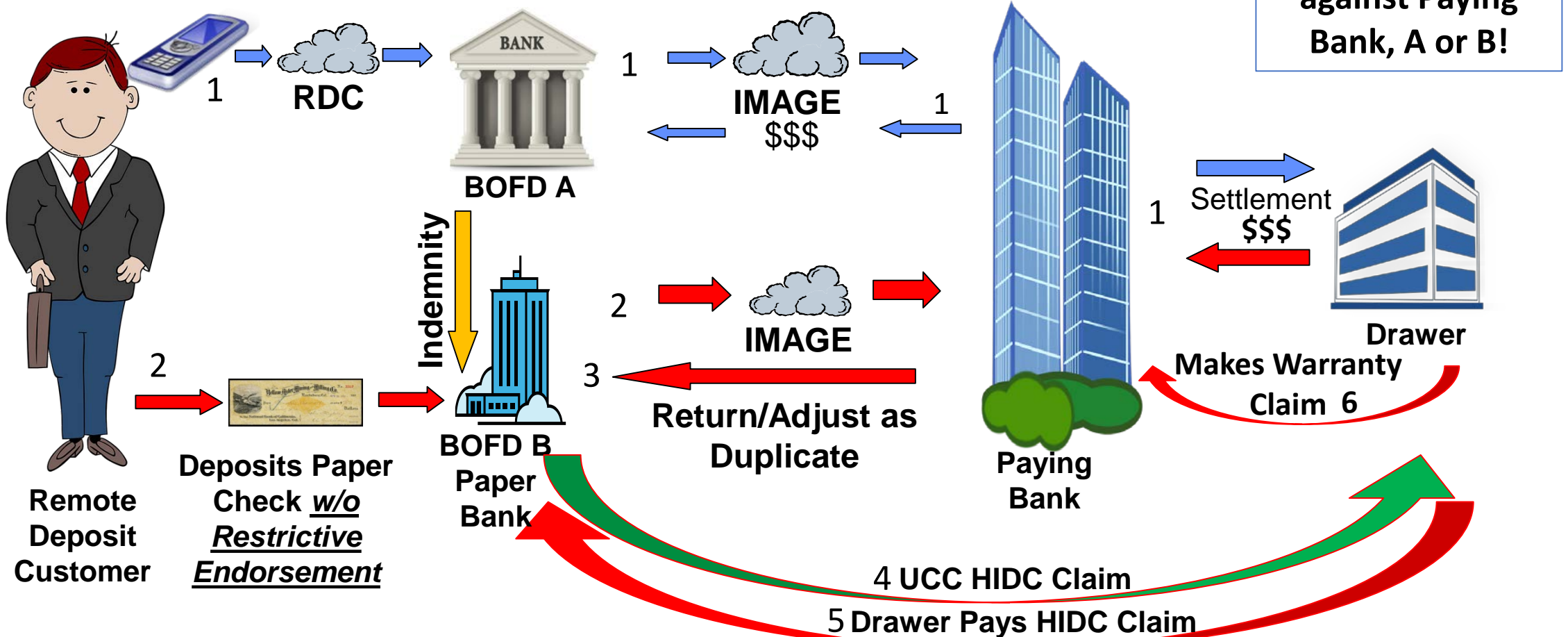


### New indemnity enforceable when:

- 1) BOFD A is an RDC bank & makes indemnity; **and**
- 2) BOFD B accepts original paper for deposit **w/o restrictive endorsement**; **and**
- 3) BOFD B receives a returned unpaid check or an adjustment; **and**
- 4) BOFD B incurs a loss

# Reg CC - New RDC Indemnity - Drawer

## • Uniform Commercial Code (UCC) Interplay



# Making RDC Claims

- **Who Can Make an RDC Claim Under New Indemnity?**

- Indemnified bank (accepting original paper check) can make claim against RDC bank(s) that permitted customer to truncate

- **How to Make Claim?**

- Final Rule does not:

- ✓ Provide instruction on how to make claim to RDC bank
- ✓ Address how indemnified bank can identify RDC bank

- **Fed Left Many Issues For Banks to Determine**

- Use return code/return system?
- Use adjustment code/adjustment system?
- Timing/deadlines for claims? For info requests?
- How get all info you need?
  - ✓ Who is the RDC bank?
  - ✓ Proof the indemnified bank actually has original item?
  - ✓ Within indemnified bank, get paper where it needs to go?

# RDC Indemnity Disclaim

- **New Indemnity is Negated if:**
  - RDC Bank has met all requirements and
  - Paper Deposit bank accepted original with a **restrictive endorsement** inconsistent with the paper deposit (e.g.; For Mobile Deposit only at ABC Bank):
- **BOFD B *May Not* Make an Indemnity Claim Against BOFD A**
  - If BOFD B accepted original check **bearing restrictive endorsement** inconsistent with means of deposit at BOFD B
- **Note**
  - Reg CC does not require restrictive endorsement when deposited at BOFD A

# Endorsements

- Endorsement vs Indorsement

- Definition

- Signature either alone or accompanied by other words for purposes of negotiating instrument, restricting payment of instrument, or incurring endorser's liability on instrument
- Information used to transfer negotiable instrument from one holder to another

# Regulation CC - Endorsement

- **Purpose for Restrictive Endorsement in Updated Regulation?**
  - To indicate:
    - ✓ Check already processed & to prevent duplicate deposit
    - ✓ Method of processing
    - ✓ Deposit restricted to specific Depository Bank
  - To protect:
    - ✓ 1<sup>st</sup> RDC FI from some duplicate claims
    - ✓ Payor
- **Restrictive Endorsement Has No Effect On Other Legal Rights**
  - Duplicate warranty

# Check Box for RDC Endorsement

- **Some Check Printers Now Include a Check Box on Back of Check for RDC**
  - Sample wording:
    - ✓ “Check here after mobile or remote deposit (with date line)”
      - Checked prior to deposit at BOFD B
    - ✓ “Check here if mobile deposit”
- **Initial Purpose – To Limit Inadvertent Duplicate Deposits**
  - Restrictive endorsement was not initially considered
- **No Guidance Yet on Check Box from Fed or Other Authorities**
- **Banks Implementing Software to Read Endorsements**
  - Some software can detect presence of and/or specific endorsements including the checked box

# Restrictive Endorsements

- Can be Stamped or Written

➤ Examples:

## Traditional

● For Deposit Only

CHECK HERE AFTER MOBILE OR REMOTE DEPOSIT  
DATE \_\_\_\_\_

DO NOT WRITE, STAMP OR SIGN BELOW THIS LINE  
RESERVED FOR FINANCIAL INSTITUTION USE ★

ORIGINAL DOCUMENT

HS-77

The security features listed below, as well as those not listed, exceed industry guidelines.

|  |   |
|--|---|
| <b>Security Features:</b> <ul style="list-style-type: none"><li>MicroPrint Line</li><li>Chemically Sensitive Paper</li><li>Security Screen</li></ul> | <b>Results of document alteration:</b> <ul style="list-style-type: none"><li>MP Small type in line appears as dotted line when photocopied</li><li>Stains or spots may appear with chemical alteration</li><li>Absence of "Original Document" verbiage on back of check</li></ul> |
|--|---|

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## More Restrictive

● For Deposit Only to Bank XYZ

CHECK HERE AFTER MOBILE OR REMOTE DEPOSIT  
DATE \_\_\_\_\_

DO NOT WRITE, STAMP OR SIGN BELOW THIS LINE  
RESERVED FOR FINANCIAL INSTITUTION USE ★

ORIGINAL DOCUMENT

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## Reg CC Restrictive

● For Mobile Deposit Only to Bank XYZ

CHECK HERE AFTER MOBILE OR REMOTE DEPOSIT  
DATE \_\_\_\_\_

DO NOT WRITE, STAMP OR SIGN BELOW THIS LINE  
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## Reg CC Restrictive

● For Remote Deposit Only to Bank XYZ

CHECK HERE AFTER MOBILE OR REMOTE DEPOSIT  
DATE \_\_\_\_\_

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# Restrictive Endorsement

- **Fed Suggested**

- “for mobile deposit at Depository Bank A only” and the customer’s account number at Depository Bank A
- This includes two elements
  - ✓ Method of handling – Mobile deposit
  - ✓ Intended depository institution

- **But, What if Item is Not Accepted at Point of Capture (e.g. poor quality)**

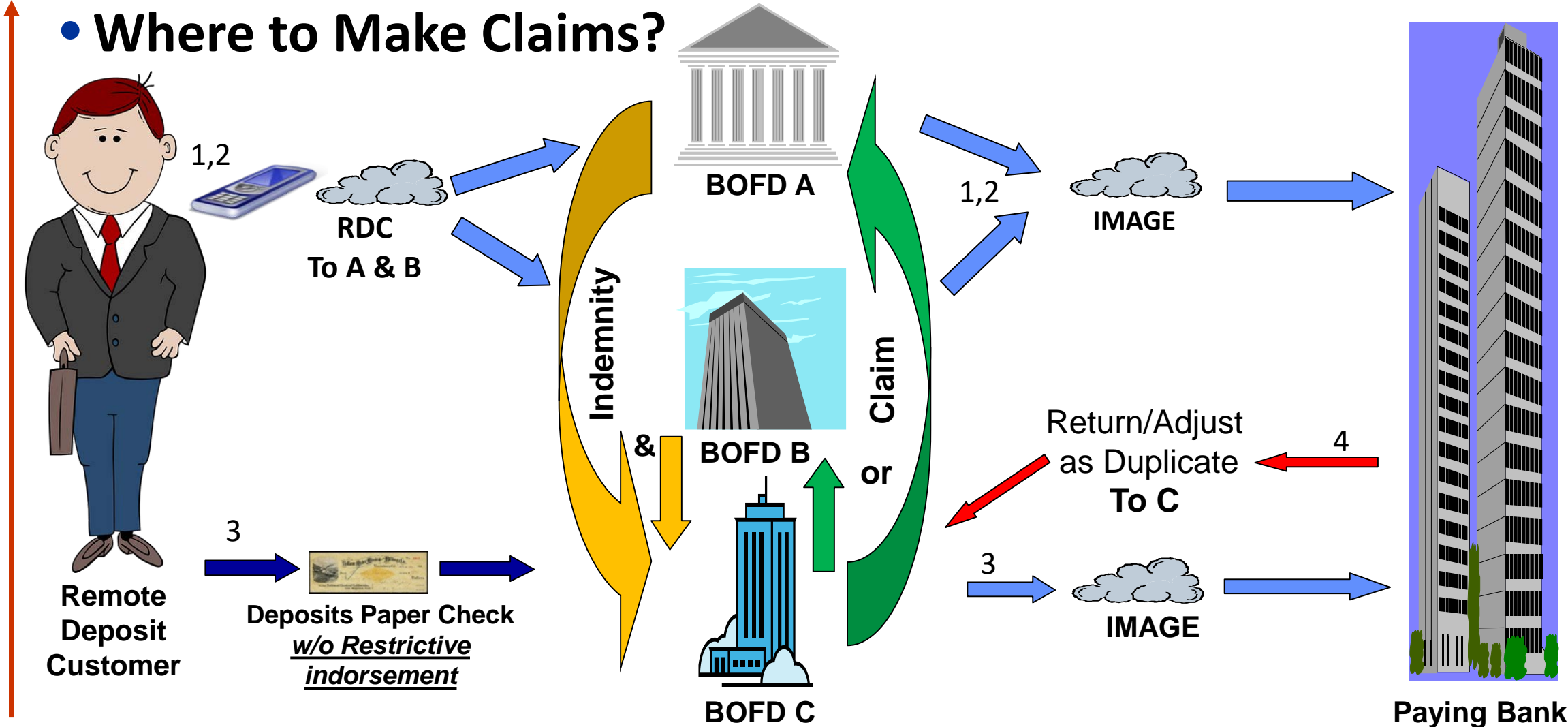
- Customer then brings check to bank to deposit
  - ✓ Teller may not accept check after “mobile deposit” endorsement

## Perhaps Better Option

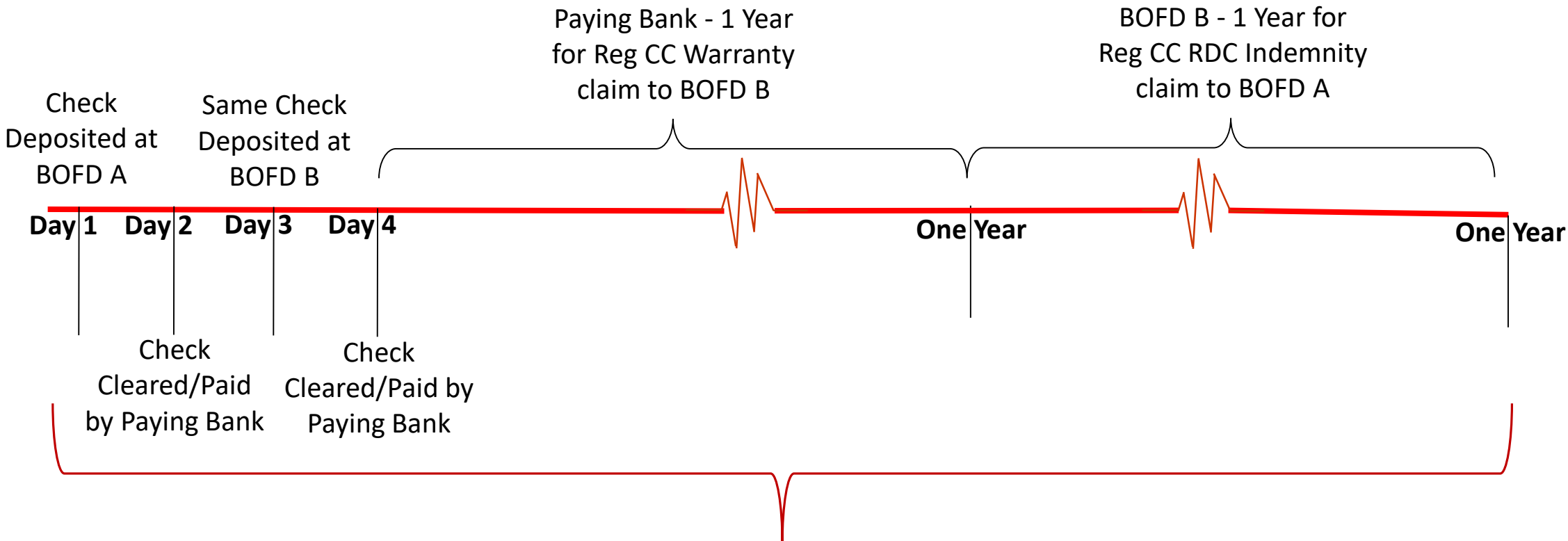
The image shows the back of a check with a restrictive endorsement. A white box highlights the text: "For Deposit Only to Bank XYZ". Below this, there is a checkbox labeled "CHECK HERE AFTER MOBILE OR REMOTE DEPOSIT" and a line for "DATE:". A horizontal line separates the endorsement area from the rest of the back of the check. Below the line, the text "DO NOT WRITE, STAMP OR SIGN BELOW THIS LINE RESERVED FOR FINANCIAL INSTITUTION USE" is printed. The words "ORIGINAL DOCUMENT" are printed vertically in large, light gray letters. At the bottom, there is a security features section with a lock icon and the text "The security features listed below, as well as those not listed, exceed industry guidelines." The section lists "Security Features" (MicroPrint Line, Chemically Sensitive Paper, Security Screen) and "Results of document alteration" (MP Small type in line appears as dotted line when photocopied, Stains or spots may appear with chemical alteration, Absence of "Original Document" verbiage on back of check). The bottom of the page includes the text "© Padlock design is a certification mark of the Check Payment Systems Association" and "★ FEDERAL RESERVE BOARD OF GOVERNORS REG. CC".

# Reg CC – New RDC Indemnity

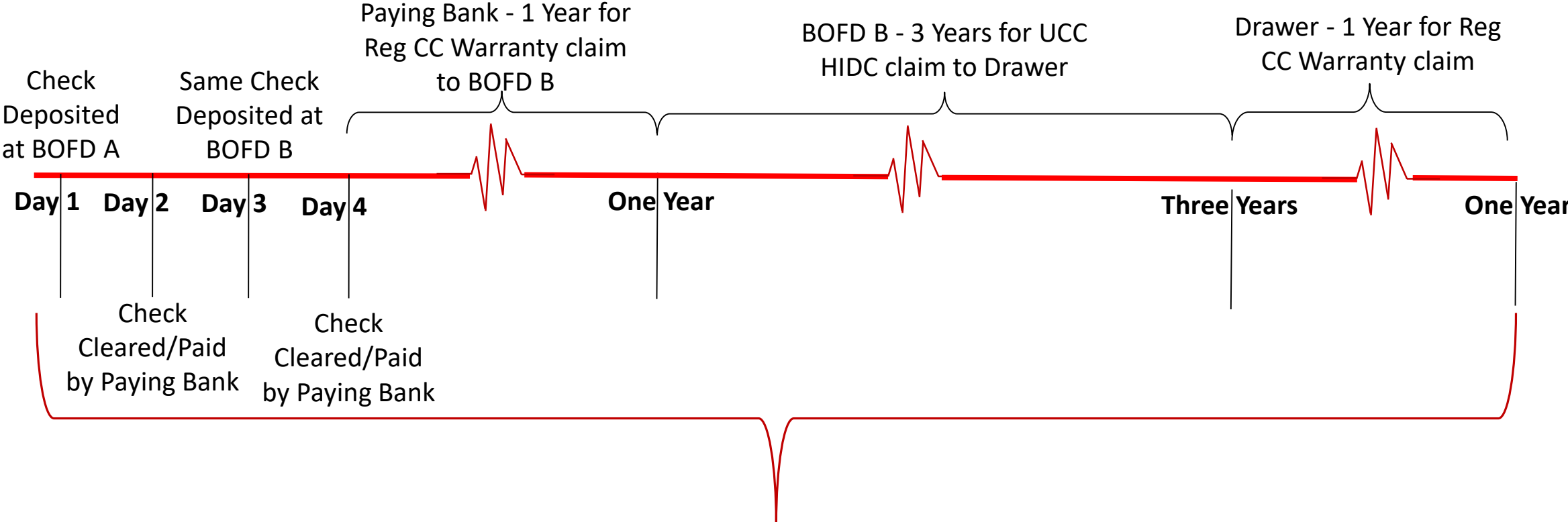
- Where to Make Claims?



# Statute of Limitations



# Statute of Limitations



**Potentially 5+ Years**

# Altered Vs. Counterfeit

- **Subsequent to Final Reg CC Provisions Effective July 1, 2018**
  - Fed issued final provision on altered vs. counterfeit items
    - ✓ Effective date January 1, 2019
- **Problem Needed Solution**
  - With image exchange, it is difficult to determine whether a check has been altered or whether it is counterfeit
  - Why important?
    - ✓ BOFD is primarily responsible for altered items
    - ✓ Paying bank is primarily responsible for counterfeit items
  - Claims had been adjudicated by three different courts with mixed results
    - ✓ Two ruled the item in question had been altered
    - ✓ One ruled the check was counterfeit
  - Needed legal guidance to achieve consistent adjudication

# Altered Vs. Counterfeit

- **Presumption of Alteration**

- Fed wished to clarify this for more consistent resolutions
- Previously, ECCHO implemented a rule under the presumption of alteration, in the absence of clear evidence to the contrary
- Fed found merit in this position and followed suit
- As of January 1, 2019 Reg CC will include the presumption that an item as been altered in the absence of clear evidence to the contrary

# Thank You!



Tiller Endeavors, LLC

*To Steer the Course You Need a Tiller!*

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# *Attachments*



Tiller Endeavors, LLC

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# Acronyms & Terms Review

- **ANSI X9 – Payments-related standards group**
- **BOFD – Bank of First Deposit**
- **BOFD A – 1st Bank of First Deposit in an RDC duplicate presentment scenario**
- **BOFD B – 2nd Bank of First Deposit in an RDC duplicate presentment scenario**
- **ECCHO – Electronic Check Clearing House Organization**
- **ECI – electronically created item (not an electronic check as defined in Reg CC)**
- **ECI Indemnity – new in Reg CC to protect against ECIs—which are not checks**
- **FRB - Federal Reserve Banks – propagates regulations and processes check, ACH and Wire Transfer**
- **MICR – Magnetic Ink Character Recognition**
- **Paper Deposit Bank – Bank accepting paper check for deposit in RDC indemnity scenario**
- **Reg CC – Regulation CC**
- **RDC – Remote Deposit Capture**
- **RDC Bank – Bank truncating a check via remote deposit in an RDC indemnity scenario**
- **RDC Indemnity – New in Reg CC to provide protection in certain conditions for depository bank that accepted deposit of paper check and then experienced a loss**
- **RFC – Request For Comment**
- **UCC – Uniform Commercial Code**

# Overview of Current Reg CC

- **Federal Reserve Regulation Governing Certain Aspects of Check System**
- **Subpart A – Definitions**
- **Subpart B – Funds Availability Provisions**
  - Implements the Expedited Funds Availability Act of 1987
  - Due to Dodd-Frank now joint jurisdiction with CFPB
- **Subpart C – Collection and Return of Checks**
  - Adopted by Fed pursuant to regulatory authority granted to it under EFAA
  - Establishes expeditious return requirement and warranties
- **Subpart D – Substitute Checks**
  - Implements Check 21 Act of 2003

# Other Reg CC Provisions

- **Definition of MICR Line**

- Includes numbers and other information contained in the MICR line data in accordance with standards
  - ✓ Commentary states standards can vary requirement for use of magnetic ink

- **Refer to Maker**

- In 2011 Fed proposed elimination of this return reason, stating it was not a reason but an instruction
- Final Rule recognizes this return reason can be appropriate in some cases
  - ✓ May be appropriate when drawer, with positive pay arrangement, instructs bank to return check
  - ✓ Not appropriate when check is being returned due to paying bank having already paid item, where check has been altered or is unauthorized

# Other Reg CC Provisions

## • **Substitute Check from Rejected Deposit**

- Bank that rejects a check submitted for deposit before transfer to the paying bank
  - ✓ Example: ATM or Lockbox deposit scenario – May provide a substitute check back to its customer
  - ✓ Bank makes Check 21 warranties and indemnification, regardless of whether bank received consideration for substitute check and this substitute check is legal equivalent of original deposited check
- X9.100-140 updated to accommodate this provision

# Notice in Lieu

- **Amended Reg CC Retains Notice in Lieu of Return**
  - Only if check is unavailable for return
  - New Commentary:
    - ✓ Notice in lieu of return is permitted only when bank does not have sufficient electronic information/image to create substitute check
- **Content of Notices Change for**
  - Notice of Non-Payment
  - Notice in Lieu
    - ✓ Information contained in MICR line

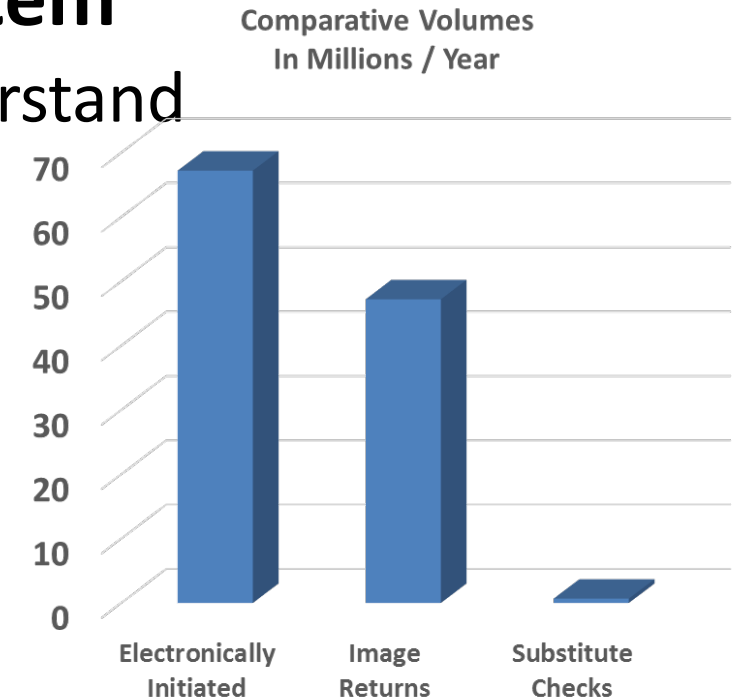
# Indorsements

- **Indorsements – Section 229.35**

- Indorsement requirements now apply directly to Electronic Checks
- Eliminates Appendix D – Indorsement, Reconverting-Bank Identification and Truncation Bank Identification Standards
- Reg CC refers to X9 industry standards for indorsements:
  - ✓ Paper check (X9.100-111)
  - ✓ Substitute check (X9.100-140)
  - ✓ Electronic check (X9.100-187)

# ECIs Going Through System

- **Not Eligible Items under ECCHO or Fed Rules**
  - Flow and endorsement same as images of paper checks for forward presentment and returns
- **But Currently Flowing Through Check System**
  - New electronic products - Many do not understand that these items are not permitted
- **About .4% of Items are ECIs According to High-Level ECCHO Study**
  - .4% is greater than return rate
  - More volume than IRDs



# ECI Covered/Not Covered

- **Reg CC ECI Indemnity is Good Start**
  - Intended to protect paying bank
- **Moves Key Questions to Agreements (e.g., ECCHO, OC3, clearing house, bilateral, etc.)**
- **Reg CC Does Not:**
  - Specify how to identify ECIs
  - Provide specific return reason code for ECI—can return as ineligible item
  - Provide adjustment process
  - Require expeditious return



# ECI Value/Considerations

- **For More Information about ECI Visit:**

- <https://tillerendeavors.com/>

- ✓ Reg J comment letter
- ✓ Summary of Reg J comment letters
- ✓ AFP Payment Operations
- ✓ Reg J – ECIs
- ✓ *Electronic Payments Stifled by Reg J – June 2018*
- ✓ *How Businesses Can Save \$20+B Annually*
- ✓ *Payment Systems Investment Decisions*
- ✓ *Digital Checks as Electronic Payment Orders*
- ✓ *EPO Forum Summary Report 2013*

# Updates: ECCHO Rules

- **ECCHO Rules Revised to Conform to New Defined Terms in Reg CC**
  - Used commonly defined terms between ECCHO Rules & Reg CC, to extent possible
    - ✓ Example: Use new defined terms “electronic check” and “electronic returned check”
- **Remove/Revise ECCHO Rules Based on Reg CC’s Direct Application to Check Image Exchange**
  - Rely on new Reg CC provisions where possible
    - ✓ Example: ECCHO Rules will rely on new Reg CC electronic check warranties
- **ECCHO Rules Updated July 1, 2018**

# Updates: Fed Rules

- **Exchanges Through Fed Governed by Regulation J and Operating Circular 3 (OC3)**
- **Regulation J – RFC**
  - Issued March 6 – Comments due May 13
  - To conform more closely with Regulation CC
    - ✓ Align rights and obligations of parties, including Reserve Banks, with amendments to Regulation CC
      - To reflect evolution of nation's check collection system from paper-based to all electronic
    - ✓ Proposed amendments clarify and simplify provisions of Reg J
      - Remove obsolete provisions, improve consistency between Reg J and Reg CC
  - Also clarify ECIs are not "items" that Reserve Banks authorized to handle under Reg J
- **OC3 Will Be Updated Once Reg J is Finalized**
  - Updates anticipated for July 1, 2018 – Still waiting