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Avoid Duplicates!

General Comment - Substitute checks under Check 21, provide an important transitional vehicle between original paper checks and more electronic checks such as image exchange. As is the case with every transition, existing controls and processes will need to evolve to address new issues created by the transition and in some cases new controls will need to be developed and implemented.

The overall industry objective is to have as few duplicates as possible in order to best serve and protect customers and to reduce the risk of loss to the bank.

What the Law Says – Under the Check 21 Act and the implementation of the Act through Regulation CC, a reconverting bank, the bank that transfers, presents or returns a substitute check for which it receives consideration, warrants to all parties in the payment stream that they will not be asked to make payment based on a check that they have already paid (no double debit). The parties in the payment stream include: depositary bank, drawee, drawer and indorser. The warranty extends to a potential duplicate resulting from a substitute check, the original check or a paper or electronic representation of the substitute check. The bank making this warranty also indemnifies all parties for all losses associated with a breach of warranty. The amount of indemnify for a breach of warranty is the amount of any loss (including interest, reasonable attorney's fees, and other expenses of representation) proximately caused by the warranty breach. Proximately caused damages can go beyond the value of the check and can include consequential damages.

While Check 21 does not cover image exchanges, most image exchange agreements will extend the coverage of Check 21 to the original imager of the check when the truncating and reconverting banks are different institutions. These agreements will likely have a similar warranty regarding duplicate images.

Under the law, the reconverting bank (the creator of the substitute check) is responsible for any duplicates that enter the banking system. It is anticipated that most image exchange agreements will provide that the original collecting bank will bear this liability as well.

Reconverting Bank – Since the reconverting bank is responsible for any damages resulting from duplicates, it is reasonable to assume that the reconverting bank should take all necessary precautions to prevent duplicates by itself or its agents. Duplicates can occur in the forward collection or return processing of substitute checks or image exchange. There are many opportunities to create duplicates including, software problems, printer problems, lack of control in handling the substitute checks.

Proper controls regarding the creation of any financial document should be implemented. These can include: validation between the input and output control totals, validation of first and last substitute checks created, physical counts of the number of substitute checks, proper restarts of printers and others. For substitute checks reprocessed through a reader sorter, the total of substitute checks sorted should be compared with the total of substitute checks that were supposed to be created.

The first requirement is for every institution that creates substitute checks to implement monitoring processes to prevent duplicate substitute checks from being created and if created to prevent the duplicates from entering the check collection or return systems. If duplicates are introduced into the payment stream, additional controls need to be implemented. At every handoff point in the collection and return of checks, there needs to be controls to identify and prevent duplicate checks and substitute checks from continuing through the payment stream.

Once in the payment stream, duplicate suspects may be treated like any other exceptions (bad image quality, gross dollar error, etc.) and so existing exception processes may be the logical "starting point" to find, qualify and control duplicate suspects.

Duplicate suspect detection needs to happen at control (file and cash letter) levels as well as at the individual item level. Given that duplicates may be created over a period of multiple days, past cycles must also be included in the duplicate detection process. Duplicate identification processes should compare original paper checks for duplicate copies of paper checks, substitute checks that are duplicates of original paper checks, substitute checks that are duplicates of substitute checks, image records of paper checks that are duplicates of original checks or substitute checks or ACH transactions.

Each institution should develop a process flow of all the possible duplication points - including cross-channel (electronic and physical), cross-cycle comparisons. Once the process flow has been completed by channel and the number of back cycles to review has been determined, it should be relatively straight forward to design edits that will identify duplicate suspects.

When duplicate suspects are identified, operational and accounting processes should be developed to facilitate review and resolution. This may include outsorting physical checks and/or images. "T" accounts and reconcilement processes need to be created to support this new activity. Staff should be identified to support the processes and to control the accounting. Subject matter experts from that staff should define the reporting, accounting and logistical requirements to perform duplicate review and reconcilement.

Banks must likewise ensure that their agents for printing substitute checks implement duplicate prevention processes that look for duplicate suspects at the control levels (files, cash letters) and at the item levels over multiple cycles, and that vendors have operational and accounting processes in place to manage duplicate suspects.

If, despite best efforts, duplicates are forwarded to another bank, a process should be in place to notify the receiving bank affected by the duplicates that includes the identification of the primary contact at the organization that created the duplicates. Care must be taken when communicating lists that contain customer information. Privacy concerns should be carefully considered before sending sensitive customer information. Where possible the institution creating the duplicates should provide notification within a few hours of learning of the problem.

Banks should consider how long to retain the original checks. Destroying the original checks early in the process will help reduce the creation of duplicates. On the other hand, there are also good reasons to retain the original check for some period of time. Banks need to weigh the various risks including any legal obligations when determining how long to retain the original item.

Receiving Bank – Legally the receiving bank has recourse to the reconverting bank for losses due to any duplicate transactions. However it is generally the receiving bank's customer who is impacted by the duplicates, so banks may want to consider receive duplicate checking. Duplicate posting to a customer's account can cause significant problems to the customer financially and damage the bank's reputation.   Duplicate checking by the receiving bank is viewed to be a difficult but not impossible task. It is understood that some banks and vendors have already built various levels of solutions. Some of these solutions may not be total solutions at this point. Duplicate checking is being done prior to posting to DDA and others are being done after the posting occurs. Some of this checking is done through the bank's fraud systems. Duplicate checking also needs to be implemented for incoming returns and adjustments

With many avenues for duplication, a comprehensive duplicate checking capability needs to look at cross channel (original paper check, substitute check, image, ACH, etc.) over multiple days at an item level. Since it is possible that items may legitimately be returned and represented, a capability to recognize these items as non duplicates need to be considered. Some banks do duplicate checking on a file, cash letter or bundle level. For complete coverage duplicates should identified on an item level. There are too many possible situations that can cause duplicates. While most banks are concerned with posting duplicates, the intraday information cannot be ignored. Today many banks update many internal systems with intraday information including wire transfer, balance reporting, teller systems and customer service. Many of these systems are communicating with some of the bank's largest corporate customers; an intraday duplicate checking capability may prove beneficial.

Once duplicates are identified, a decision has to be made as to which item is the "real" item and which is the "bad" item. A duplicate identified by the receiving bank should be handled as an adjustment back to the reconverting bank, not as a return to the BOFD. Unfortunately there are scenarios in which a bank may not be aware that an item is a duplicate, it looks like a return and is therefore handled as a return. Once a duplicate is returned to the BOFD who was not the reconverting bank a customer account will be charged for the item, causing additional problems to customers including the potential for additional bounced checks. The bank's internal Adjustments and Returns departments need to be included in decisions regarding the return of duplicates.

Banks may also want to consider whether they notify customers of real or potential duplicates.

Conclusion – Check 21 is a new environment for both the sending and receiving parties. An error caused by one party in the payment system may have an affect on many other parties. The industry needs to work together to find and eliminate duplicates.