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This P.R.E.P. Guide ("the Guide") is intended as only one study resource for persons preparing to take the NCP Exam. Exam candidates should use a range of primary and secondary materials in addition to this Guide to review topics related to check payments. Review of this Guide alone may not be sufficient to achieve the NCP certification. See resources and other reference materials listed on the NCP pages at www.eccho.org/ncpc.

The purpose of the Guide is to aid those preparing for the annual NCP Exam as well as to solicit comments for future editions. Blank “Comments/Notes” pages are included at the end of each section for you to capture your notes, work through questions or jot down suggestions you may choose to share. Please forward any comments or questions about the NCP program or this Guide to:

Ellen Heffner, NCP
Director
NCP Program Manager
eheffner@eccho.org or ellen.heffner@theclearinghouse.org

Call toll Free: 877-273-7316

The Clearing House Payments Company L.L.C. makes no warranties, expressed or implied, regarding a person’s use of this Guide as a preparation tool for the NCP Exam. Certain sections of this Guide are subject to change in future editions without notice to any person.
SECTION ONE – THE PROGRAM

A. NCP PROGRAM OVERVIEW

The National Check Payments Certification Program is intended, in part, to recognize an elevated level of payments acumen among payment professionals. Since 2005, the check payment system has undergone sweeping changes unlike anything previously seen in U.S. payments history. With image exchange and remote deposit capture for consumers and businesses, the processing of paper checks is now truly de minimis.

Through the certification process, National Check Professionals (NCPs) will demonstrate a working knowledge of every significant aspect of the check payment system including products and operations, relevant rules and laws that govern checks, industry standards and fraud and risk mitigation considerations. NCPs will explore those characteristics of check payments that make checks unique among payments that continue to provide lasting value for tens of billions of payments each year valued at tens of trillions of dollars.

Finally, the NCP becomes a recognized expert payments professional – a knowledgeable and valuable industry resource. Through study to prepare for the exam and through on-going continuing education, the NCP is an individual whose education benefits themselves, their employer and their customers. To see what other industry professionals are saying about the NCP program, visit the website’s “Testimonials” page at: www.eccho.org/ncpc_testimonials.

1. Certification and Goals
   - Why become an NCP? A National Check Professional (NCP) designation recognizes professionals who have successfully proven a broad level of understanding of the current check payments landscape. The program supports the future of check and the development of check professionals
   - Certification sets the NCP apart by:
     - Recognizing the knowledge and comprehension of check payments
     - Recognizing the NCP as a leader in various fields
     - Strengthening professional credibility
     - Demonstrating commitment to stay on the leading edge of industry trends and topics
     - Positioning the NCP for professional advancement

2. National Check Professional (NCP)
   - Ideal Candidate: To study, sit for the exam and achieve a passing score to earn the NCP certification, the “ideal candidate” should:
     - Have a minimum of two years of experience in the financial services industry
     - Have a desire to learn more about check payments as a whole
     - Have relevant experience in check or check image operations, treasury, product, card, fraud and/or risk

3. The NCP Program
   - Presented by ECCHO, a service of The Clearing House Payments Company L.L.C. (“ECCHO”)
   - Includes a formal training process offered in conjunction with a nationwide group of NCP Educational Partners, and culminates with a three-hour 120 question multiple-choice examination
SECTION ONE – THE PROGRAM

- Exam topics are categorized into four knowledge areas:
  - Rules, Laws, and Regulations
  - Fraud and Risk Mitigation
  - Check Operations
  - Check Products
  - See Exhibit 1 for an outline of topics, or “blueprint” of check payments knowledge domains that may be included in any given administration of the exam
  - Exam topics and the NCP Exam Blueprint, can also be viewed online at: www.eccho.org/ncpc_exam_blueprint

- Editorial Board: Team of subject matter experts (SMEs) drawn from the ECCHO membership and the industry with broad professional experience and expertise
  - Individuals with the experience to develop and help maintain the certification program, to write and review test questions, and establish the level of performance required for certification
  - Group works under the guidance of ECCHO and the Human Resources Research Organization (HumRRO)
    - HumRRO is an independent, nonprofit corporation with expertise in all aspects of the credentialing, to build a valid and fair certification process following established professional and regulatory guidelines

- Exam Administration: Exams are administered by PSI Exams Online (PSI) by appointment only and only at authorized test center locations. The annual exam is a proctored computer-based test (CBT) accessible only by appointment at authorized PSI Test Centers

4. Policies and Procedures Overview

- Details of the NCP program examination are outlined in the NCP “Policies and Procedures” document. This includes:
  - Education options, program training resources and continuing education requirements
  - Examination information including exam dates, registration process, exam administration, information on the exam day at the PSI test center, and exam results
  - NCP information including use of the NCP® logo, the certification period and maintaining the certification
  - ECCHO as program certifying agent
  - Copyright and ownership of program materials and confidentiality of the exam
  - Policy Exceptions
  - Fee Schedule

- For a complete copy of the program “Policies and Procedures” go to: www.eccho.org/policies_and_procedures

5. Program Milestones

- The following outlines key dates in the annual exam registration, preparatory training, and testing process. For additional information on the current year’s exam, visit our website at www.eccho.org
SECTION ONE – THE PROGRAM

<table>
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<tr>
<th>Dates</th>
<th>Key Program Tasks</th>
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<tbody>
<tr>
<td>Jan - Apr:</td>
<td>Educational Partners offer exam prep training</td>
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<td>Note: Training generally begins in January timeframe but may begin earlier depending on each partner’s schedule. Check with the NCP Partner for specifics on scheduling and pricing <a href="http://www.eccho.org/ncp-partners-providers">www.eccho.org/ncp-partners-providers</a></td>
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<tr>
<td>Mar 31:</td>
<td>NCP Exam registration deadline – Late registrations may be accepted up to April 30th (or last business day of month) with a $50 late fee</td>
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<td>Note: Test center locations and appt. options could be limited - early registration is recommended</td>
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<td>Feb - May:</td>
<td>ECCHO sends a confirmation code to each registrant to be used when scheduling an appointment with PSI Exams Online</td>
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<td>Prior to desired exam date:</td>
<td>Registrant schedules appointment with PSI Exams Online</td>
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<td>3rd weekend in April for 3 weeks</td>
<td>NCP testing window; exam is administered once annually</td>
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B. PARTNERS AND EDUCATION

The NCP program is supported by a group of partners that promote the exam, provide check payments training and partner with ECCHO to deliver customized exam prep training each year. This includes both program partners and NCP Educational Partners. It is important to note that due to the broad range of topics and complexity of many subject areas aligned to the NCP Exam, additional education and study may be helpful. Whether instructor-led or self-study courses, study focus should include all topics covered by the NCP Exam blueprint.

1. Program Partners
   - Support the NCP program through marketing the NCP exam to encourage individuals to be certified as National Check Professionals
     - Develop and maintain their own education programs

2. Educational Partners
   - Offer the NCP Core Training materials or supporting educational programs in direct support of the NCP Exam
   - Participate in the development and review of those programs with ECCHO
   - Certify one or more of their staff as NCP Class Instructors
   - Promote and market the exam and training programs to encourage individuals to:
     - Utilize exam prep and training review programs; and
     - Register and take the NCP Exam
Three partners joined ECCHO in 2010 as the initial NCP Educational Partners:
- Upper Midwest Automated Clearing House Association, Inc. (UMACHA)
- Viewpointe Clearing, Settlement and Association Services, LLC (Viewpointe)
- Wisconsin Automated Clearing House Association (WACHA)
  - These organizations supported the program through direct involvement with
    ECCHO in building and delivering the initial NCP Pilot Exam training review
    sessions in 2011

NCP Program and Educational Partners currently include:
- ePayResources
- EPCOR (Electronic Payments Core of Knowledge)
- First National Bankers Bank (FNBB, Inc.)
- PaymentsFirst
- MACHA (Mid-Atlantic Payments Association)
- NEACH (New England Automated Clearing House)
- Southern Financial Exchange (SFE)
- TCH Payments Authority
- United Bankers’ Bank (UBB)
- UMACHA (Upper Midwest Automated Clearing House Association)
- WesPay (Western Payments Alliance)
- WACHA (Wisconsin Automated Clearing House Association)

3. NCP Education Program

- Customized training program maintained by ECCHO that forms the basis of the Core
  Curriculum for NCP Exam prep training

- Includes a recommended eleven (11) training sessions across a wide range of
  topics:
  - Check Payments and Check Processing
  - Regulations - Uniform Commercial Code
  - Regulations - Regulation CC – Part I
  - Regulations - Regulation CC – Part II
  - Standards and Formats
  - Image Exchange: Rules and Agreements – ECCHO Rules
  - Image Exchange: Rules and Agreements – Fed OC 3
  - Image Exchange: Processes
  - Exceptions - Returns and Adjustments
  - Check Products
  - Fraud, Risk and Risk Mitigation
    - Note: Sessions may be presented by individual NCP Educational Partners
      in a different order than shown here

- Additional preliminary prep classes and/or Exam Review(s) are also recommended

- Training topics align to the four knowledge domains covered by the examination:
  - Rules, laws and regulations
  - Fraud and risk considerations
  - Check Operations, and
  - Check Products
SECTION ONE – THE PROGRAM

• Educational program materials are designed to assist in the candidate’s preparation to take the NCP Exam
  – Exam candidates should have existing experience and are strongly encouraged to commit to self-study to prepare for the exam (see Ideal Candidate information in section “A. NCP Program Overview” in this document)

• Materials are updated annually to reflect changes in the check payments industry and/or to align to updates to the NCP examination blueprint

• Training materials that comprise the NCP Core Curriculum are shared annually with NCP Educational Partners
  – NCP partners currently deliver the annual NCP Exam prep training series
  – Information on pricing, scheduled training dates and available training formats (webinars, on-demand recordings, in-person reviews, etc.) are available on each partner’s website
  – Links available at: www.eccho.org/ncpc_training

4. NCP Exam References

• NCP exam covers a broad range of source material.
  – See the NCP Roadmap for study and exam prep suggestions and general guidelines for how to plan an individual course of study
  – Note: “NCP Roadmap – Your Roadmap to Success” is distributed to all candidates upon registration with ECCHO for the NCP exam

• Various industry materials were referenced when developing exam questions and are recommended throughout this guide. For a complete list of recommended additional reading and resource materials, please see Section Two – Training, Program Overview that follows and Exhibit 2 to this guide or visit the website at: https://www.eccho.org/ncpc_training

• Questions? Please email NCP Connect program mailbox at ncpc@eccho.org

C. CONTINUING EDUCATION PROGRAM

This section provides an overview of the NCP continuing education requirements. Every National Check Professional (NCP) is required to meet current program renewal requirements to maintain the NCP certification. This includes earning and filing the required CE credits and completing continuing education workshops as defined in the program.

1. CE Program Overview

• General information about the program is listed here. Details are outlined in the document titled “Continuing Education Program Guide” and on the website at: https://www.eccho.org/ncpc_cont_edu

• This Continuing Education Program Guide includes:
  – General description of the program
  – Continuing Education (CE) renewal requirements
  – ECCHO-hosted NCP Workshops outline
  – Sources for NCP CE Credits
  – Certification period
SECTION ONE – THE PROGRAM

- Credits filing process, related deadlines and fees
- Audit process
- Providers of approved NCP CE credits and:
  - Providers rights to use NCP program marks, and
  - Provider credits pre-approval process and fees
- Program contacts

- Passing the Exam earns the NCP a certification period beginning the year in which the certification is earned and the five full years following the year in which the certification is earned

- To extend the Certification for another five-year period, the NCP must complete both:
  - 50 NCP Continuing Education Credits aligned to the approved exam topics; and
  - Three (3) ECCHO-hosted NCP Workshops in the five-year period

- CE Credits (“Credits”)
  - Credits may come from a variety of sources including conferences, industry group meetings, user group meetings and many other training and educational options
  - Credit-eligible sessions may be offered in a variety of formats including:
    - In-person meetings
    - Lunch-and-learn sessions
    - Webinars
    - Teleconference training
    - Video and/or audio on-demand self-paced study
  - Credit eligibility for a given session is based on the inclusion of subject matter elements that align with the currently approved list of exam topics (See Exhibit 1 NCP Examination Blueprint in this Guide)

- NCP Workshops
  - ECCHO offers three (3) Workshops annually
    - Generally targeted for May, August and November (subject to final scheduling)
  - Workshops are hosted by and tracked by ECCHO and therefore are not required to be filed as part of the annual Credit filing process
  - Workshops may be “live” webinar or recorded session

- Highlights – Additional Continuing Education Opportunities:
  - NCP Guide Program: NCPs earn free continuing education credits while assisting NCP exam candidates prepare for the exam.
    - NCP exam candidate, once registered for NCP exam, can request a free personal Guide to help explain how best to prepare for exam
      - For more information, visit website at: https://www.eccho.org/ncp_guide
  - National NCP Day: Annual day celebrating accomplishments of all NCPs
    - Generally held in August each year
    - “Live” education session and recordings of past sessions available for NCP CE credits
      - Visit website for more information and links to prior year recordings and presentations: www.eccho.org/ncp_ncpday
SECTION ONE – THE PROGRAM

- ECCHO Insights: Complimentary webinar(s) offered by ECCHO on relevant industry “hot topics”
- ECCHOEd: a library of online check education recordings

- Other CE Credit Ideas:
  - Community service related to check payments
  - Team “Lunch-and-Learn” sessions
  - Lead a training session
    - Get double credits as instructor if session is a minimum of 50 min. and includes at least 3 other people attending the session
  - Internal training requirements with topics that align to the NCP Exam blueprint
  - Piggy-back with someone in the organization participating in NCP Exam Prep Training on a purchased ECCHO-hosted NCP Workshop
  - View an ECCHO Insights session from the webinar archive
  - Purchase and view an ECCHOEd on-demand session
    - Visit https://www.eccho.org/ecchoed for more information

- For additional ideas on meeting these requirements, see the Continuing Education webpage at: www.eccho.org/ncpc_cont_edu
### COMMENTS/NOTES

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SECTION TWO – TRAINING GUIDE

A. OVERVIEW OF SUBJECT AREAS AND RESOURCES

Learning Objective: This section provides an overview of the certification program and the general subject areas which form the basis for the NCP exam questions and this training guide.

This “Section Two – Training” is built around the four subject areas and is designed to provide each test candidate with check payments system information, reference materials, and recommended resources for additional self-study. Review questions will follow most sections and Exhibit 10 at the end of this guide contains the Answer Key for all quizzes found in this Guide. For more information about the NCP program, please visit: www.eccho.org/ncpc.

1. Overview – Need for Check Knowledge and NCP Program

   Virtually 100% of all checks are processed electronically through various channels including private sector exchange and via the Federal Reserve Bank. Recent industry studies show check images average more than 12 billion checks annually with a value over $20 trillion. Check system improvements have greatly increased the efficiency of the check payments system and enabled huge industry savings.

   However, overall industry check expertise has declined. The resulting gap in current check knowledge creates a gap and a need for check payments training. Bridging this gap is one of the key goals of the NCP program which will, through the successful completion of the NCP exam, certify check professionals who demonstrate an expert level of knowledge of the check system.

   In 2010, ECCHO launched the NCP program, working with the Human Resources Research Organization (HumRRO) to provide blueprint development, test development, test administration, standard setting, and scoring support for the examination. The current NCP Exam is a three-hour proctor-monitored computer-based exam of 120 multiple-choice questions. The NCP Exam provides professionals with the opportunity to demonstrate their competence across four key knowledge domains of check payments.

   Exam questions are created and updated by a group of industry experts known as the NCP Editorial Board under the direction of ECCHO and HumRRO. The primary role of the Editorial Board is to create, periodically review and update the annual certification test questions to measure knowledge in each of the examination subject areas.

   • Reference materials used by the Editorial Board to prepare the current exam and that are referenced in this training are listed on the NCP Training page at: www.eccho.org/ncpc_training. In addition, the following documents may be referenced throughout this document for recommended additional reading. These include, but are not limited to:
     - ASC X9, Inc. standards (Accredited Standards Committee, Financial Services)
     - ECCHO Operating Rules and Commentary
     - Federal Reserve Operating Circulars (www.frbservice.org)
     - FFIEC Guidance handbooks (www.ffiec.gov)
     - Uniform Commercial Code – Article 3 & Article 4
     - Regulation CC and Regulation J
2. **NCP Examination Blueprint**

The blueprint for the examination describes in an outline format the four key knowledge domains of check payments – the category subject areas for the certification exam. Each of the four categories and related topic areas included in the NCP Examination Blueprint have a percentage weighting factor based on the focus on that area of knowledge. Those four main categories are:

- **Rules, Laws, and Regulations**: Demonstrate a working knowledge of key terms and concepts with respect to ECCHO Rules, Uniform Commercial Code (UCC) Articles 3 and 4, Regulation CC, Regulation J, Federal Reserve Operating Circular 3 (OC3) and selected sections of NACHA Rules and Regulation E.

- **Fraud and Risk Mitigation**: Demonstrate knowledge required to identify fraud and mitigate risk associated with check products and services and to comply with the regulatory requirements including the Uniform Commercial Code Articles 3 and 4, Bank Secrecy Act/Anti-Money Laundering (BSA/AML), and the Federal Financial Institution Examination Council (FFIEC) guidance.

- **Operations**: Demonstrate a comprehensive understanding of all aspects of check operations including item processing, file control, clearing and settlement, exception handling and returns, and account statements. In addition, demonstrate awareness of key standards such as ANSI and ACH formats for check conversion.

- **Products**: Demonstrate a basic knowledge of the types, benefits, and purpose of correspondent banking products and customer (commercial and consumer) products. These include Image Cash Letter (ICL), Remote Deposit Capture (RDC), Positive Pay, Controlled Disbursement, and electronic check conversion products.

For a complete listing of the NCP Examination Blueprint and the relative weightings, also see *Exhibit 1.*

3. **Exam Preparation – Studying for the Exam:**

It is recommended that all candidates for the NCP exam have a minimum of two years’ experience in the financial services industry and a desire to learn more about check payments as a whole. This experience may include payments professionals working in check, ACH, treasury, cash management, compliance, product, card, and fraud and risk mitigation areas.

- See the NCP Study Center for a listing of links to study tools made available to all registered exam candidates upon registration with ECCHO.
B. PAYMENTS SYSTEM HISTORY

Learning Objective: This section will provide a brief overview of the key developments in the check payments as checks have transitioned from a paper-based environment to an electronic (image) based check system.

1. U.S. Check Payments System

- The origin of the check predates the United States and has firm legal roots in English law. Pre-1970, all checks were written and collected as paper payment instruments.
- During 1970s credit unions began a process known as safekeeping
  - Paper check was stopped in the collection cycle at the paying institution and not returned to the customer.
  - Customers’ paper statements included information about each check that was paid against their accounts
  - Original paper check was not included in the statements.
- During the 1980s there were a few banks that began experimenting with exchanging information about checks that could be used for posting or for reporting information to customers about checks that would be posted in the next processing cycle.
- In 1990, ECCHO was formed and the first nationwide electronic check presentment (ECP) exchanges were initiated in which MICR line information was transmitted across the country to paying banks prior to the arrival of the original paper checks.
  - Paying banks used the electronic information for posting.
  - ECP accelerated posting and the return of unpaid items.
- During the 1990s, the Federal Reserve began making MICR line information available to banks in the Michigan Upper Peninsula to overcome physical delays because of winter weather.
  - Original paper checks followed as soon as possible.
- During the 1990s, the Federal Reserve began offering products to support forward collection and returned items based on early delivery of MICR line information and delayed delivery of the original paper checks.
  - Banks began offering image statements during this period.
- During the late 1990s, NACHA began offering a variety of check conversion products based on using the original paper check as a source document which was converted to an ACH debit transaction.
  - Products introduced confusion about whether these were covered by check law or Regulation E.
- During the 1990s, the Financial Services Technology Consortium (FSTC) created project known as Paperless Automated Check Exchange & Settlement (PACES)
  - Vendor-neutral solution to clearing checks using image exchange.
  - ECCHO developed the first private sector image exchange rules to support the PACES project.
At the end of the 1990s, the Federal Reserve implemented Electronic Presentment Image Check (EPIC)
- Program was based in Helena, Montana and included imaging checks, archiving the images and transmitting the images to the paying bank for posting
- Return decisions were made and unpaid checks could be returned directly from the Fed to the BOFD

During the early 2000s, the Federal Reserve made its first ever legislative proposal to Congress, the Check Clearing for the 21st Century Act (Check 21).
- Check 21 overcame a key barrier to check truncation by creating a new legal instrument, the substitute check.

Between 2005 and 2011, the volume of substitute checks grew rapidly and then declined just as rapidly due to the growth in image-enabled options for exchange

Remote Deposit Capture (RDC) appeared between 2005 and 2011 as banks began offering services that allowed customers to deposit images of checks via transmission from remote locations.

From January 2005, when ECCHO began tracking check image volumes, through current day, checks received as images grew exponentially resulting in virtually all checks being collected via image exchange

See Figure 2.1 for a snapshot of check image volumes, shown as Average # of Images Received Daily), as reported to ECCHO by various sources including:
- Federal Reserve Bank, Viewpointe, The Clearing House, selected ECCHO Full and Participating Members and other local / regional exchanges.
C. CHECK PAYMENTS

**Learning Objective:** This section will provide an overview of the check as a payment instrument and will provide the basics including the parts of the check, related definitions, how checks are exchanged, and an overview of the legal framework for the exchange.

In general, the purpose of a check is to transfer funds. The following section provides a more specific definition and will review the regulations and the rules and agreements that form the legal framework for the exchange of checks.

1. What is a check?
   - Statutory and regulatory bodies define a check as a “written order directing a bank to pay money as instructed”. Specifically, the Uniform Commercial Code (UCC) and Regulation CC (Reg CC) provide the following definitions:
     - **UCC 3-104:** A check is a negotiable instrument or an unconditional promise to pay; a draft payable on demand and drawn on a bank. Further sections as noted below define the check as:
       - Draft payable at a financial institution (UCC 3-106)
       - Designed to transfer amount of money for which it is written (UCC 3-104)
       - On or after the date specified on the check (UCC 3-108)
       - To specific payee or to the bearer (UCC 3-104/3-109)
     - **Reg CC §229.2(k):** A check is a negotiable demand draft:
SECTION TWO – TRAINING GUIDE

- Drawn on or payable through a bank, a Federal Reserve Bank, or the US Treasury,
- Drawn on a state government or unit of local government that is *not* payable through or at a bank
- US postal money order or a traveler's check and
- Can be either an original check or a substitute check
  - Term check does not include a noncash item or an item payable in a medium other than United States money
  - Draft may be a check even though it is described on its face by another term, such as money order

  Reg CC §229.2(ggg) also defines the electronic check and electronic returned check as
  - An electronic image of, and electronic information derived from, a paper check or paper returned check, respectively, that:
    - Is sent to a receiving bank pursuant to an agreement between the sender and the receiving bank; and
    - Conforms with ANS X9.100-187 standard

2. Parts of the Check and Parties to the Check

- A standard six-inch personal check, generally used for consumer accounts, is shown in this section with the parts of the check identified. The terms shown in these examples are drawn from the ANSI X9.100-160-2015 standard "Magnetic Ink Printing (MICR) Part 1: Placement and Location”. For a detailed review of the MICR standard, visit the X9 website at www.x9.org.

- MICR line - Routing number: Numbering system identifying all US financial institutions with each having its own unique number(s)
  - Many financial institutions are assigned and use more than one routing number

- Note: Routing number field and the number contained there may also be referred to as the:
  - ABA (American Banking Association) number
  - RTN (routing transit number)
  - RT (routing transit)

- Routing number – What does it represent? The example in Figure 2.2 provides a simple illustration of this field:

Figure 2.2 Routing Number Field
SECTION TWO – TRAINING GUIDE

- Nine digits of the routing number field are defined below including the Federal Reserve Routing number, the ABA institution identifier, and the check digit
  - Federal Reserve Routing (values 01 – 12)
    - Note: first 2 digits = 00 for U.S. Government
  - Digits 1 – 4, where the first 2 digits represent Fed district
    - 01 Boston 07 Chicago
    - 02 New York 08 St Louis
    - 03 Philadelphia 09 Minneapolis
    - 04 Cleveland 10 Kansas City
    - 05 Richmond 11 Dallas
    - 06 Atlanta 12 San Francisco
  - 3rd Digit: Represents branch office serving the bank
  - Looking again at Figure 2.2 for the 12th District:
    - 1 San Francisco
    - 2 Los Angeles
    - 3 Portland
    - 4 Salt Lake City
    - 5 Seattle
  - 4th digit may have different values in different Fed districts
  - ABA Institution identifier – Digits 5 – 8
  - Check digit – Digit 9: Calculated value; for details see standard X9.100-187, Annex F – Check Digit Calculation

- Routing Number Forms: Two forms of routing number currently in use
  - MICR form: Nine-digit machine readable format used in automated processing
    - Example shown in Figure 2.2
  - Fractional form: Legacy format; relied upon when checks were manually-sorted
    - Useful today to aid in identifying check fraud
      - Example using RT in Figure 2.2, fraction form = 91-03/1221
  - Both forms should appear on checks and drafts

- Fractional Format
  - Numerator includes: City prefix (1-49) or state prefix (50-99);
    - Prefix is followed by the ABA institution identifier.
  - Denominator: Federal Reserve routing symbol
  - Fractional form and MICR form numbers must match.
  - Uses of routing number in fractional form:
    - To determine how to route an item if the MICR line is damaged
    - For fraud control - by comparing the MICR line information to fractional form information

- All characters on the MICR line are in E-13B font
  - Characters are generally written in magnetic ink, though it is possible for the characters to be in the correct font but not printed in magnetic ink
  - E-13B font consists of the following character set
    - Numbers: 1 2 3 4 5 6 7 8 9 0
    - Special symbols include
      - Transit symbol: †;
SECTION TWO – TRAINING GUIDE

- Amount symbol: $
- On-Us symbol: 
- Dash symbol: –

MICR line fields are numbered and described moving from right to left as illustrated on the sample check in Figure 2.3.

- Note: While the terms “Field 1” or “Field 2” are not included in the standards to describe these fields, this terminology from an industry processor may commonly be used to describe these areas on the MICR line. Both terms are shown in the following examples:

  - **Amount Field** – Field 1: Area of the MICR line on the document where the dollar amount is encoded; 12 positions hold 10-digit number and the amount symbols; the symbol [$] in the E-13B font identifies the field
  - **On-Us Field** – Includes Fields 2, 3, and 4
    - Variable area of the MICR line generally specified by the financial institution on which the check is drawn; may include such information as drawer’s account number, a check serial number, or other transaction or processing codes. The on-us symbol ([*]) is to the right of the account number and an additional on-us symbol is permissible but discouraged
      - Field 2: Serial Number Field
      - Field 3: Account Number Field
      - Field 4: Optional Field 4
  - **Routing Field** – Field 5: Routing number or numeric identifier of a financial institution as assigned by the American Bankers Association (ABA) or its agent; used for routing purposes on checks and other MICR documents such as deposit tickets and check processing batch tickets. The Routing Field is bracketed by the two transit symbols ([*) - one on each side of the number.
  - **EPC or External Processing Code Field** – Field 6: Single digit field located to the left of the routing number, reserved for special codes that tell financial institutions and other processors information regarding the correct handling or routing of a check or check data
  - **Aux On-Us Field** – Field 7: Figure 2.3 illustrates the position of the added MICR line information – the Auxiliary On-Us (Aux On-Us) field on a business-sized check

- For more information on the MICR line see part “K. STANDARDS” in this section
A larger check, longer than six inches, is generally used for business checking accounts. Figure 2.4 illustrates this check.

- External Processing Code Field (Optional)
  - ABA Routing Number
  - 9 digits, no spaces
  - Bounded by transit symbols

Aux On Us Field: Can optionally include serial number or other transaction or product code.
SECTION TWO – TRAINING GUIDE

- A standard personal check, generally used for consumer accounts, is shown in Figure 2.5
- This graphic shows the parties to the check including:
  - Drawer: Party making the payment or the writer of the check
  - Payee: Party to whom the check is written or the party receiving payment
  - Paying Bank / Drawee Bank: Bank holding the account on which check is drawn
  - Depositary Bank or Bank of First Deposit (BOFD)
    - Bank where the check is deposited or cashed
  - Endorser: Payee who has assigned the right to collect the amount to someone else

Figure 2.5 Parties to the Check

3. Check Processing Overview

- With the introduction of the substitute check and the rapid growth in image exchange processes, check payments today are exchanged primarily as images. The following two views illustrate a basic forward presentment process where check images are now replacing paper checks.
  - Figure 2.6 shows a basic paper check forward collection process followed by the same flow with the check payments exchanged as images
- In these examples, not the following:
  - On-us items: Drawn on the bank of first deposit or BOFD; and
  - Transit items: Drawn on a bank other than the BOFD
    - Illustrated as flowing through several different channels to reach the Paying Bank through:
      - Direct exchange with the Paying Bank
      - Exchange via the Federal Reserve Bank, or
      - Other correspondents or clearing banks
Figure 2.6 Forward Collection Typical Flows: Paper and Image

“Day in the Life of a Check (Paper)”

“Day in the Life of a Check (Image)”

- Forward collection and return of checks today are handled as images where “virtual” processes replace paper processes.
- Growth in image exchange has been supported by:
  - Elimination of critical legal barriers such as the unilateral truncation of paper checks, supported by the substitute check;
  - Consolidation of Fed offices and the movement to all electronic processes;
  - Acceptance and growth in Remote Deposit Capture (RDC) and mobile RDC services.
4. Item Processing Overview

- Checks can be cleared via multiple channels including:
  - As a physical check (less likely today);
  - As an image;
  - Converted image to substitute check (IRD); or
  - As an ACH debit (if check is eligible for conversion) to one of the following entries:
    - ARC – Accounts Receivable Entry
    - POP – Point-of-Purchase Entry
    - BOC – Back Office Conversion Entry

- In general, check payments processing impacts each of the following:
  - Availability – Funds available to account holder for withdrawal or other use
    - May include funds from an overdraft/line of credit product as well as funds classified as available balance such as from cleared and existing deposits
    - Available Balance – Funds in account available for immediate use
      - Generally, the balance as of previous business day's processing, plus or minus any pending transactions, direct deposits that have not posted, or bank holds
  - Float – Banks receive checks for deposit and apply provisional credit to the account of the check depositor
    - Timing of clearing (collection / settlement of funds from bank upon which check is drawn) can result in “float”; Can be positive or negative float
      - Negative float: Customer Float billed is greater than Bank Float incurred
        - Negative position from customer’s point of view
        - Bank has use of funds prior to providing availability to the customer
      - Positive float: Bank Float incurred is greater than Customer Float billed
        - Positive position from customer’s point of view
        - Customer has access to funds available for use prior to the bank’s collection and final settlement
    - Delays in check clearing result in checks in the process of collection appearing briefly in the accounts of both Depositary Bank and Paying Bank

- Exceptions – Any transaction in the form of a paper, image or electronic entry that requires further investigation before final disposition
  - Returns and adjustments are both exceptions
    - Return – Paying Bank determines not to pay a check based on a specific reason
      - May be customer return reason or for an administrative reason
      - Must indicate item is a return and the reason for return, and
      - Must return in accordance with statutory and regulatory guidelines
      - For additional information on returns and customer and administrative reasons for returns, see part “L. Exceptions: Returns and Adjustments” in this Section Two
    - Adjustment – Involve researching and resolving errors generally caused during item processing such as mis-encoding, mis-routing, incorrect posting, etc.
Adjustments may be sent through the Federal Reserve or through a private sector provider.
Adjustment types relate to specific conditions and must meet the requirements for that adjustment type to be processed; examples include: timing to file the adjustment claim, dollar thresholds and any required supporting documentation.

The following outline covers at a high-level the general activities that occur upon receipt of checks at the processing center and those activities that would occur the following day. For a more detailed review of the check operational process, please see part “J. Check Operations” in this Section Two.

Operational processes are typically divided into “Day 1” and “Day 2” where:

- Day 1 Functions would include:
  - Process incoming / outgoing cash letters and deposits
  - Proof
  - Capture
  - Repair
  - Balancing and Reconciliation
  - Posting to accounts (customer and GL)

- Day 2 Functions would include:
  - Handling and resolution of exception items
  - Exceptions: Items rejected from DDA posting on Day 1
  - May be handled as returns or adjustments
  - Incoming Returns/Chargebacks
  - Research and Adjustments

Typical Processes – Day 1 (most are all image-based today)

- Receive incoming file from remote deposit channels or other financial institutions
  - May also receive paper cash letter
  - Work Set-up /Proof & Encoding if required

- Image quality analysis (IQA) and Code line match

- Electronic (virtual) capture process
  - Edit rules and field validations
  - Duplicate item detection

- Image reject / repair processes
- Balancing
- File transmission(s)
  - Create and transmit outgoing electronic image cash letter
- Settlement
- File Control - Management of file receipt and transmission
  - Critical control process to ensure all files are properly received and/or sent and are processed/settled with correct totals
    - Confirmation and verification of control totals
    - Preparation of cash letters (paper and/or check image files) for input into the capture application or for dispatch/transmission
      - Duplicate file detection and prevention
- Archiving
  - Image archive or bulk file for any paper
SECTION TWO – TRAINING GUIDE

– DDA Posting
– Settlement & Reconciliation

• Typical Processes – Day 2

– Image exceptions
  o Create return item pull file to retrieve images from archive
  o Examine image to identify BOFD or utilize indorsement records if received
  o Electronic (virtual) encoding for:
    • BOFD
    • amount
    • return reason code

– Outgoing returns: Create outgoing image cash letter file
  o Transmit file to Federal Reserve Bank, clearinghouse, correspondent, or other bank

– Incoming returns: Items matched to bank’s All Items File; may be either:
  o Charged back to depositing customer
    • Images of items to be charged back provided to customer
    • Printed notice sent or IRD created
  o Re-presented
    • Items to be re-presented are segregated and uploaded to today’s workflow
    • Can eliminate need to re-process through Proof and Encoding

• Day 2 – Adjustments (Paper and Image)
  – Item retrieval
  – Adjustment case resolutions

• Statement Processing
  – Check enclosure items pulled from bulk filing system (paper) or archive (image) and sent for statement processing
    o Statements may be made available online or sent to customers
  – Statement types may include:
    o Safe-keeping statement
      • Check number and dollar amount provided
    o Image statement
      • Image of paid items, other account information
    o Online statements
      • Account information available online
    o Enclosure statements
      • Physical paper check and other enclosures

5. Overview of Legal Framework for Image Exchange

• Warranties and related indemnities in the exchange of check images come from different sources including:
  – Laws (Uniform Commercial Code, Regulation CC, Regulation J, etc.)
  – Rules (ECCHO Rules and Federal Reserve operating circulars)
  – Agreements (bilateral and multilateral agreements)
• To determine which law or set of rules apply, must determine whether item is:
  – Original physical item
    o Paper check – see UCC Articles 3 and Article 4 and Reg CC
  – Substitute Check
    o Regulation CC – Subpart D
    o Some provisions in image rules
  – Electronic check and electronic returned check – Reg CC and based on the clearing channel:
    o Private sector clearing house rules (ECCHO Operating Rules); or
    o Federal Reserve rules – OC3 and Regulation J; or
    o Other bi-lateral or multi-lateral agreements
  – Remote Deposit Capture (RDC) items (business and consumer)
    o Customer agreements to cover liabilities and responsibilities

• See Figure 2.7 below for general relationship of check payment laws, rules and other agreements

Figure 2.7 Check Payments: Laws, Rules and Agreements

• Role of Laws, Rules and Agreements for Image Exchange
  – Regulation CC defines the electronic check and electronic returned check
    o Subpart C of Reg CC applies directly to interbank electronic check exchange
    o Subpart D (Check 21 Act) supports substitute checks
  – Reg CC defers to interbank rules and agreements to establish many of the terms of exchange; for example:
SECTION TWO – TRAINING GUIDE

- Where/how/when electronic checks are delivered;
- Whether banks will act as intermediary banks for exchange/return;
- Exceptions and variations as permitted;
- Terms for dealing with exceptions and adjustments.
  - Interbank rules/agreements apply UCC to electronic checks in interbank exchange
  - Interbank rules may also require a bank exchanging under those rules to make additional warranties and indemnities when exchanging images in forward presentment or return; for example:
    - Warranty under ECCHO Rules for Forged or Counterfeit check (Rule 9)
  - UCC and the bank-to-customer agreement addresses remote deposit capture (RDC) deposit, payment and the customer relationship

6. Suggestions for Further Study

- Regulation CC (12 CFR Part 229): Availability of Funds and Collection of Checks
- Regulation J (12 CFR Part 210): Collection Of Checks And Other Items By Federal Reserve Banks And Funds Transfers Through Fedwire
- FFIEC Guidance handbooks: See http://www.ffiec.gov for complete listing
- Uniform Commercial Code (UCC) Article 3 - Negotiable Instruments; Article 4 - Bank Deposits and Collections at: www.law.cornell.edu/ucc

7. Review Questions

- The following questions are a review of key points covered in this section to be used to further aid in the study of these topics. See “Section Four – Exhibits - Exhibit 10” for the Answer Key.
  - What do Article 3 and Article 4 of the Uniform Commercial Code (UCC) cover?
  - What does Federal Reserve Regulation CC implement?
  - Where are the electronic check and the electronic returned check defined?
  - Describe the following check routing number in fractional form and define each part? Fractional RT = 91-03/1221
  - The aux on-us field on a check is typically used for what purpose?

D. OTHER PAYMENT SYSTEMS

Learning Objective: This section provides a high-level review of other payment systems that are frequently used today. As previously described, the U.S. Payments System has developed over many years beginning with cash and checks then developing into many other payment mechanisms.

Below are descriptions of other commonly used payments systems including the Automated Clearing House (ACH), Wire Transfer, Debit Card Network and Credit Card Network.

1. Automated Clearing House (ACH)

- Funds transfer system governed by the rules of NACHA
SECTION TWO – TRAINING GUIDE

- Provides for the inter-financial institution clearing of electronic entries for participating financial institutions

- Participants involved in a typical ACH transaction include:
  - Originator – Originating company or individual
    - Entity who agrees to initiate ACH entries into the payment system
    - Originator is usually a company directing transfer of funds to or from a receiver’s account (consumer or another company)
    - Originator may also be a merchant
  - ODFI – Originating Depositary Financial Institution
    - Entity who receives the payment instructions from Originator and forwards them to the ACH Operator
    - ODFI is responsible for all entries originated through the ODFI whether by an Originator or through a third-party sender
      - ODFI is responsible for its Originators and third-party senders’ compliance with the ACH rules
  - ACH Operator: Central clearing facility that receives entries from ODFIs, distributes the entries to the appropriate RDFIs and performs the settlement functions for the financial institutions
    - Two organizations act as ACH Operators:
      - Federal Reserve Bank
      - Electronic Payments Network (EPN) of The Clearing House (TCH)
  - RDFI – Receiving Depositary Financial Institution (RDFI)
    - Entity that receives ACH entries from the ACH Operator and posts them to the account of its depositors (Receivers)
    - RDFIs that participate in the ACH network must agree to receive all types of ACH entries
  - Receiver – Receiving company, employee or customer
    - Entity may be a consumer or organization that has authorized an originator to initiate an ACH entry to the Receiver’s account with the RDFI

- ACH entry may either be a credit or a debit transaction
  - Unlike a check, which is always a debit instrument

- ACH credit applications may include:
  - Annuities, dividends, interest payments, payrolls (private and government), pensions (private and government), Social Security payments, tax payment, vendor/corporate to corporate payments and others

- ACH debit applications may include:
  - Association dues, cash concentration, insurance payments, mortgage/installation loan payments, point of sale purchases, utility payments, tax payments, charitable donations and others

- Check Conversion
  - Transforms a payment initiated by paper check that has not been negotiated to an electronic payment, into an ACH transaction
  - Payment is no longer under check law but covered by provisions of electronic banking regulations
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- Check is no longer a “check” but is considered a “source document”
  - Entries for check conversion products can be:
    o Back Office Conversion Entry (BOC)
    o Point of Purchase Entry (POP)
    o Accounts Receivable Entry (ARC)
  - Refer to part “E. Rules and Agreements / 3. NACHA – Automated Clearing House (ACH) Rules” in this Section Two for more detail on NACHA rules and the Check Conversion chart in Exhibit 4

- Figure 2.8 provides a very simple graphic illustrating the forward flow of Check and ACH processes for general comparison purposes

Figure 2.8 Check and ACH Comparison

- Figure 2.9 provides a high-level comparison of the key components of ACH Check Conversion and Image Exchange payments systems.
- The table shows various points of comparison including:
  - Comparative legal frameworks
  - Risk considerations
  - Required authorizations
  - Eligible items
  - Formats
  - Timing
  - Other factors
### Figure 2.9 Check and ACH Comparison

<table>
<thead>
<tr>
<th>Component</th>
<th>ACH Check Conversion</th>
<th>Image Exchange</th>
</tr>
</thead>
<tbody>
<tr>
<td>Legal Framework</td>
<td>Consumer and ACH Rules and regulations:</td>
<td>Check Law</td>
</tr>
<tr>
<td></td>
<td>• Regulation E</td>
<td>• UCC, Reg CC, Reg J, Check 21</td>
</tr>
<tr>
<td></td>
<td>• NACHA Rules</td>
<td>• ECCHO Rules</td>
</tr>
<tr>
<td></td>
<td>• Some Check Law</td>
<td>• Fed Operating Circulars</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Other agreements</td>
</tr>
<tr>
<td>Risk</td>
<td>Reduced Risk due to faster returns</td>
<td>Reduced Risk due to accelerated posting and faster returns</td>
</tr>
<tr>
<td></td>
<td>• Risk Shifted from RDFI (paying bank) to ODFI (collecting bank)</td>
<td></td>
</tr>
<tr>
<td>Authorization</td>
<td>Originator obtains authorization from Receiver</td>
<td>Signature on instrument is authorization</td>
</tr>
<tr>
<td></td>
<td>• Flows with transaction from ODFI to RDFI</td>
<td>• Paying Bank responsible for verifying signatures</td>
</tr>
<tr>
<td>Returns</td>
<td>All returns electronic</td>
<td>Electronic image returns</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Very few paper returns today</td>
</tr>
<tr>
<td>Eligible Items</td>
<td>Consumer</td>
<td>All Payments — consumer and business</td>
</tr>
<tr>
<td></td>
<td>Some Business Payments</td>
<td></td>
</tr>
<tr>
<td>Originators</td>
<td>Fls, Billers, Corporations, Retailers, Companies</td>
<td>Bank to Bank</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• RDC from customer (consumer or corporate)</td>
</tr>
<tr>
<td>Dollar Limits</td>
<td>$25,000; $2,500 for some items</td>
<td>No limits</td>
</tr>
<tr>
<td>File Formats</td>
<td>ACH Rules</td>
<td>ACS (Accredited Standards Committee)</td>
</tr>
<tr>
<td></td>
<td>• 94 Characters</td>
<td>• Mainly 80 characters except for image records</td>
</tr>
<tr>
<td></td>
<td>• SEC code identifies the application and format</td>
<td>• X9.37 (Federal Reserve)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• X9.100-187</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• UCD (now TR 47)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• X9.100-188 (return codes)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Posting data and images</td>
</tr>
<tr>
<td>Timing</td>
<td>Usually next day</td>
<td>On Demand</td>
</tr>
<tr>
<td></td>
<td>• Value dated</td>
<td>• Posting and settlement when presented</td>
</tr>
<tr>
<td></td>
<td>• Originate prior to settlement</td>
<td></td>
</tr>
<tr>
<td>Capacity</td>
<td>Sufficient</td>
<td>Sufficient</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Runs in Check operation</td>
</tr>
</tbody>
</table>

2. **Wire Transfer**: Refers to large dollar, instantaneous electronic funds transfers

- Characteristics of wire transfers include:
  - Large dollar transactions
  - Immediate availability
  - Irrevocable payments
- To “wire funds” is to transfer cash value from one bank to another with almost immediate availability of the funds.
Domestic payment systems offering financial wire transfer services include:

- Clearing House Interbank Payments System (CHIPS)
  - Electronic payments system operated by The Clearing House that transfers funds and settles transactions in U.S. dollars
- Fedwire of the Federal Reserve
  - Funds transfer system operated by the Federal Reserve Banks used to make large-value, time-critical payments

Wire Transfers are governed by:

- UCC Article 4A – Funds Transfer;
- Regulation J (for Fed Wire); and
- The Clearing House Interbank Payments System (CHIPS) Rules and Administrative Procedures

3. **Debit Card Network:** Generally, uses the shared ATM networks that offer payment services associated with a financial institution’s DDA systems

- Also known as Debit networks
- System uses a card that is a device issued by a company (usually a financial institution) allowing the user to purchase goods and services from merchants who accept the card
  - Card is used to access the user's depositary account (checking account) for funding.

4. **Credit Card Network:** System that uses a device issued by a company to allow the user to purchase goods and services from merchants who accept the card.

- Credit Card: Payment card issued to a person for purchasing goods and services and obtaining cash against a line of credit established by the issuer
  - May be of two types: those issued by merchants and vendors (such as a store) and those issued by banks (such as VISA and MasterCard)
- Cardholders may also be able to receive other bankcard services
- Card holder’s account balance can be paid for over time generally with added interest on revolving account balances

5. **Review Questions**

- The following questions are a review of key points covered in this section and may be used to further aid in the study of these topics. See “Section Four – Exhibits - Exhibit 10” for the Answer Key.
  - Describe the participants involved in a typical ACH transaction.
  - What are the dollar limits for ACH check conversion?
  - What is Wire Transfer and when would it generally be used?
E. RULES AND AGREEMENTS

Learning Objective: This section will provide a high-level overview of the primary rules and agreements across the industry that relate to the exchange of check images. This includes rules provided by the ECCHO, a service of The Clearing House Payments Company L.L.C., and the Federal Reserve’s Operating Circular (OC3) utilized by the Federal Reserve Banks for their image exchange products and services. A brief overview of the NACHA rules for ACH payments is also included.

Note: Updates to Federal Reserve Operating Circular 3 (OC 3), to conform to Regulation CC and Regulation J final amendments, were not released or available for review at the time this Guide was published. Provisions of Fed OC 3 listed in this Guide are not updated awaiting publication of OC 3 revisions by the Federal Reserve.

1. ECCHO Operating Rules and Commentary

- Overview and Purpose: ECCHO, as service of The Clearing House Payments Company L.L.C., is a check clearinghouse whose membership consists solely of U.S. depository institutions. The ECCHO Operating Rules and Commentary ("Rules") are clearinghouse rules under the Uniform Commercial Code ("UCC"). As clearinghouse rules, the terms of the ECCHO Rules may vary provisions of the UCC with respect to a person interested in a check processed under these clearinghouse Rules. As a national clearinghouse, ECCHO seeks to facilitate the exchange of electronic check transactions between depository institutions of all sizes throughout the United States.

- The Rules recognize and build upon existing check law, such as the UCC and Regulation CC of the Federal Reserve Board.

- ECCHO Rules apply only to members of the clearinghouse and only govern electronic check/electronic returned check transactions between two Members.
  - A Member of ECCHO is not permitted to use (whether by private agreement of the parties or otherwise) the ECCHO Rules to attempt to govern an electronic check transaction between the Member and a non-Member entity.

- ECCHO Rules may include a related Commentary section that further describes the intended purpose of the Rule, the possible application of the Rule to various hypothetical situations, and additional implementation issues for consideration by Members in complying with the specific Rule.

- Changes to the ECCHO Rules are approved by the ECCHO Business Committee which considers input on suggested changes from the Operations Committee of ECCHO, individual Members, and Sponsoring Organizations.

- Changes to the ECCHO Rules are binding on all Members of ECCHO, as of the effective date established by the Business Committee upon approval of the Rules update.

- The following is a listing of key provisions in the ECCHO Rules. To review or download a complete copy of the rules, visit the ECCHO website at: http://www.eccho.org. See also part “H. Exchange Considerations: Private Sector and Federal Reserve” of this Section Two for a more detailed review of the key rules
provisions governing image exchange and a comparison of private sector rules and the rules that govern exchanges through the Federal Reserve Banks.

- Definitions
- Rules Overview
- Compensation
- Items Eligible for Exchange and Routing Information
- Deadlines
- Repair
- Third Party Agent
- Electronic Check Formats
- Settlement
- Compensation
- Presentment
- Data Security Electronic Check Information
- Data Confidentiality
- Obligations of Organization; Clearing House
- Adjustment Claims and Adjustment Matrix
- Amendments
- Dispute Resolution Procedures
- Image Exchange and Return of Imperfect Image Items
- Presentment
- Exchange Arrangements
- Transmission of Images of Savings Bonds for Redemption by U.S. Treasury
- Exchange of Images of Canadian Items
- Electronic Check
- Electronic Returned Checks
- Remotely Created Check Warranty (Rule 8)
- Forged and Counterfeit Check Warranty (Rule 9)

2. **Federal Reserve Banks Operating Circular No. 3 – Collection of Cash Items and Returned Checks**

- **Overview and Purpose:** Operating Circular 3 (OC3) along with Subpart A of Regulation J, Subparts C and D of Regulation CC and the appendices and time and fee schedules apply to the handling of all cash items that the Fed sends or receives for forward collection and returned checks. The circular:
  - Includes instructions to paying, collecting, returning and depositary banks for handling and paying all items from and to the Federal Reserve
  - Covers related services provided by the Fed
  - Issued pursuant to the Federal Reserve Act, the Expedited Funds Availability Act, the Check Clearing for the 21st Century Act (Check 21 Act) and related statutes and in conformity with Regulation J and CC
  - Binding on all parties interested in an item that is handled by the Fed
  - Provisions vary by agreement certain provisions of certain sections of the Check 21 Act, the Uniform Commercial Code or Regulation CC

- **Key Provisions:** OC3 includes the following provisions:
  - Items that the Fed handles as Cash Items
  - Items that the Fed does not handle as Cash Items
  - Definitive Securities; Noncash Items
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- Electronic access to the Fed's Check Services
- Preparation of Cash Letters and Return Letters
- Image Cash Letters and Image Return Letters
- Sending items to any Fed bank
- Time Schedules and Availability of Credit
- Routing Number; Records
- Shipment and Presentment
- Settlement for Cash Letters
- Designation of Settlement Account
- Corrections; Adjustments
- Time Limits and Locations for Claims and Actions
- Mis-sent Cash Items
- Returned Checks
- Notice of Nonpayment
- Charges
- Adjustments for certain warranty claims; errors
- Certain claims with respect to electronic items or substitute checks
- Missing or destroyed cash items and returned checks

3. NACHA – Automated Clearing House (ACH) Rules

- Overview and Purpose: The NACHA Operating Rules and Guidelines are produced by the National Automated Clearing House Association. The Rules serve as the definitive source of information governing the exchange and settlement of electronic funds transfers through the Automated Clearing House (ACH). The Rules provides users with the legal framework for the ACH Network, while the Guidelines provide guidance on implementing the rules. The rules are fair and equitable, which govern the ACH Network, guiding risk management and creating certainty for all participants.

- ACH rules cover the following provisions
  - General Rules
  - Rights and Responsibilities of ODFIs, their Originators and Third-Party Senders
  - Rights and Responsibilities of RDFIs and their Receivers
  - Rights and Responsibilities of ACH Operators
  - Rights and Responsibilities of Gateways for IAT Entries
  - Rights and Responsibilities of Associations and the National Association
  - Settlement
  - Definition of Terms
  - ACH File Exchange Specification
  - Specifications for Data Acceptance by ACH Operators
  - ACH Record Format Specifications
  - Return Entries
  - Notifications of Change
  - Acknowledgment Entries
  - Compensation Rules
  - Rule Compliance Audit Requirements
  - Arbitration Procedures
  - Rules Enforcement
ACH Check Conversion – When a paper check or other eligible paper item is converted to an ACH transaction, the check is no longer under check law but is covered by the NACHA rules with consumer coverage under Reg E. The SEC codes RCK and XCK are exceptions to this and are not covered by Reg E but continue to be checks under check law. The following provides a brief overview of three check conversion Standard Entry Class (SEC) codes:

- ARC – Accounts Receivable Entry
  - Check provided to biller for payment by mailing a check via U.S. mail, placing in a drop-box or in-person at manned bill pay location
- POP – Point-of-Purchase Entry
  - Made at point of purchase with check voided by merchant and returned to consumer
- BOC – Back Office Conversion Entry
  - Made at the point-of-purchase, or at manned bill pay location for subsequent conversion during back office processing, with check held by merchant

In addition, the following SEC codes are used to create check replacement entries:

- TEL – Telephone-Initiated Entry
  - A single or recurring entry consumer debit transaction, made upon oral authorization obtained over the telephone
- WEB – Internet-Initiated/Mobile Entry
  - Transaction authorized on the Internet or wireless network
- RCK – Re-presented Check Entry
  - Returned check due to insufficient or uncollected funds re-presented electronically through the ACH instead of check payments channel
- XCK – Destroyed Check Entry
  - Used to collect certain checks that have been lost, destroyed or are otherwise unavailable for check processing

For more details on each of the SEC codes discussed here, refer to the chart in Exhibit 4 at the end of this section. For those SEC codes listed, the chart includes the title, short description, key components of that entry, the authorization requirements and other considerations such as what is required to print on the consumer’s statement.

For specific usage and other details and requirements for entries within the ACH network, review the NACHA Operating Rules and Guidelines.

4. Agreements

Overview and Purpose: Certain aspects of the exchange process are left to agreement of exchanging banks. Operational agreements are needed to address the logistics of a specific exchange.

Banking Practice Agreements

- Agreements work in conjunction with the rules and specify certain processing and logistical aspects for image exchanges. Such agreements, sometimes called a Banking Practice Agreement (BPA), outline specific operational aspects for the exchanges and may be incorporated with other network or clearing house rules. In general, the BPA:
States the agreement of the parties to exchange under the rules and may also include:

- Agreement to use specific rules for image exchange
- Start date(s) for exchanges (forward and return)
- Image file formats and related companion document
- Routing number identification (for File Header Records)
- Eligible RTs
- Location for delivery of presentment notices and images
- Image Ledger Cut-off Time
- Deadlines
- Exchange Network
- Settlement Process
- Communication facility
- Settlement Process or Organization
- Adjustments Process or Organization
- Rules provisions that can be varied

- Bank-to-Bank Agreements
  - Banks may also enter into agreements to cover their private sector (non-Fed) exchanges. Such agreements can be bi-lateral or multi-lateral agreements and may be oral/normal course of dealing arrangements supplemented by written business/technical requirements. Agreements may also be provided by third party processor or settlement bank.

- Other Agreements
  - **Bank-to-Customer Agreements**: Bank-to-bank rules, such as clearing house rules, apply only to financial institution members of the clearing house. Customer-to-Bank exchanges are covered by agreements such as deposit account agreements and those needed for image-enabled services such as remote deposit capture (RDC).
    - Banks should review key points in the guidance from the Federal Financial Institution Examination Council (FFIEC) regarding risk mitigation and reporting requirements to ensure all points are covered when developing the RDC customer agreement. Some examples include:
      - Type of customer that may use the service
      - Deposit thresholds
      - Handling of rejects, corrections, and adjustments
      - Data security of non-public data when transmitted from the customer location to the bank
      - Handling/correction of duplicate entries
      - Retention / destruction of original checks
  - **Bank-to-Vendor Agreements**: Banks may also choose to use an outside organization for some or all of its check processing. In such cases a vendor agreement is required to address liabilities and responsibilities of a third-party agent in creating and sending check images and/or substitute checks. Such considerations would include:
    - Compliance with check laws, clearinghouse rules, industry standards
    - Liability for duplicate check images or substitute checks that may be created/sent
    - Liability for release of original check
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- Backup warranties from vendor for warranties made by bank to other parties in check collection system
- Scope of indemnity/liability that vendor will agree to pick up
  - For example, Check 21 has potential for consequential damages for Reconverting Banks

5. Suggestions for Further Study
   - Federal Reserve Banks Operating Circular No. 3; Collection of Cash Items and Returned Checks: [http://www.frbservices.org/regulations/operating_circulars.html](http://www.frbservices.org/regulations/operating_circulars.html)

6. Review Questions
   - The following questions are a review of key points covered in this section and may be used to further aid in the study of these topics. See “Section Four – Exhibits - Exhibit 10” for the Answer Key.
     - What options are available in the U.S. for image exchange rules coverage? True or False?
     - ECCHO Rules may be used to cover the exchange of a check image via remote deposit capture from a merchant to a depository bank. True or False?
     - What is a Banking Practice Agreement?

F. REGULATORY ENVIRONMENT

Learning Objective: This section will provide an overview of the statutory and regulatory provisions that govern payments including the Uniform Commercial Code (UCC), Regulation CC, Regulation J, and Regulation E.

1. Check law is based on both statutory and regulatory provisions including those outlined below. Each of the following will be discussed in more detail in this section.
   - Uniform Commercial Code (UCC)
     - Developed with efforts towards uniform laws for sales and other commercial transactions in all 50 states
     - Organized as “articles” each dealing with a different subject area
       - Article 3 covers negotiable instruments
       - Article 4 cover bank deposits
       - Article 4A covers funds transfers
   - Code of Federal Regulations (CFR) - Title 12 Banks and Banking
     - Codification of the general and permanent rules published by the executive departments and agencies of the Federal Government
     - Code of Federal Regulations (CFR) is updated annually
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- Divided into 50 “titles” or parts that each represent broad areas subject to Federal regulation, for example:
  - 12 CFR Part 205 – Regulation E: Electronic Fund Transfers
  - 12 CFR Part 210 – Regulation J: Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers Through Fedwire
  - 12 CFR Part 229 – Regulation CC: Availability of Funds and Collection of Checks

2. Uniform Commercial Code (UCC)

Overview and Purpose: The Uniform Commercial Code (UCC) is a set of standardized state laws that govern financial contracts. The code, first published in 1952, establishes general duty standards for parties to act in good faith and exercise ordinary care in their transactions. UCC is enacted in one or more versions in all 50 states and District of Columbia, Puerto Rico, Guam and the U.S. Virgin Islands.

- Article 3 and Article 4 (dealing with negotiable instruments and related bank deposits and collections) was revised in 1990 with other updates in the interim
- Together with case law, Articles 3 and 4 document legal boundaries for most aspects of check processing
- UCC and draft revisions written by experts in commercial law with updates submitted as drafts for approval the Uniform Law Commission (ULC)
- UCC Article 3 – Negotiable Instruments
  - Establishes the general duty standards for parties to act in good faith and exercise ordinary care. Also covers the definition and requirements of a negotiable instrument including:
    - Negotiation, transfer and indorsement of these instruments, and
    - Liability of the parties
  - Sample topics included in UCC Article 3:
    - Standards of care required for processing checks
    - Establishing the identity of the payee
    - Contradictory terms of instrument
    - Negligence of drawer in case of forgery or alteration
    - Forgery and fraud loss allocation
    - Transfer and Presentment warranties
- Negotiable instruments may be either drafts or notes
  - Instrument is a note if it is a promise to pay
  - Instrument is a draft if it is an order to pay; checks are drafts
- See the simple graphic in Figure 2.10 below for the overall view of the elements required for a negotiable instrument, that is a draft, to be considered a check.
As illustrated above, the negotiable instrument is:

- Written instruction signed by the drawer
- Unconditional order to pay a fixed sum of money, unless it states:
  - An express condition to payment or is subject to or governed by another record (rights or obligations with respect to the order stated in another record)
- Payable on demand or at a definite time
  - On Demand: Payable on demand or at sight, or otherwise indicates that it is payable at the will of the holder
    - Does not state any time of payment
  - Payable at Definite Time: Payable on elapse of a definite period of time after sight or acceptance or at a fixed date or at a time readily ascertainable at the time the order is issued
- Date of instrument: May be antedated or postdated
  - Instrument payable on demand is not payable before the date of the instrument
  - If antedated (stale-dated): Bank has option to pay/not pay the item
  - If undated, its date is:
    - Date of its issue; or
    - Date it first comes into possession of a holder
- Payable to order of a named payee or to bearer;
  - To bearer if it states that it is payable to:
    - Bearer or to the order of bearer; or
• To cash; or
• Not payable to an identified person; or
• Does not state a payee;
  o Otherwise the person in possession of the order is entitled to payment

• Negotiation of the instrument
  – Result of transfer of possession from holder to another person or bank who becomes holder as result of the transfer

• Holder: Person in possession of a negotiable instrument that is payable either to bearer or to an identified person that is the person in possession

• Holder and Holder in due course
  – Holder in Due Course (HIDC): Holder that has possession of the item and:
    o Took the item in good faith
    o Took item for value
    o Without notice the signature was unauthorized or the item altered
    o Without notice the instrument was overdue or dishonored
    o Without knowledge of any claims against it
  – Not every holder is a holder in due course
    o Depends on the facts and circumstances
  – Benefit of being a holder in due course
    o Can enforce the item against the drawer even if item was returned unpaid by drawee (Paying Bank)

• Presentment: Demand for payment made to drawee (Paying Bank)
  – Consider each of the following for presentment:
    o Location for presentment
      • Can be by agreement of the parties
      • Made at place of payment by any commercially reasonable means including:
        ✓ Oral, written, or electronic communication (if electronic presentment is authorized)
    o When is it effective?
      • When demand for payment is received by drawee
    o What is provided to the Drawee?
      • Must provide Drawee the instrument unless otherwise agreed by the parties
        ✓ Such as in electronic presentment agreements
      o Drawee may return or refuse without dishonoring:
        • Return for lack of a necessary indorsement, or
        • Refuse payment for failure of presentment to comply with terms of instrument, agreement of parties, or other applicable law or rules
    o Timing of Presentment?
      • Drawee may establish cut-off hour
        ✓ May treat presentment as next business day after day of presentment if items presented after cut-off hour
  – When presentment occurs, starts several processes:
    o UCC and Reg CC return clocks
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- Paying Bank requirement to settle for a properly payable item
  - Properly payable item: Item authorized by the customer and in accordance with agreement between customer and bank
- Paying Bank also has right to charge customer’s account (if bank chooses to do so) under their customer account agreement

- Transfer and Presentment Warranties
  - For UCC Article 3 Transfer and Presentment Warranties (3-416 and 3-417), see part “G. Warranties and Indemnification” in this section for details

- UCC Article 4 – 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 included in UCC Article 4:
      - When a bank may charge a customer’s account
      - Customer’s right to stop payment
      - Electronic Presentment
      - Transfer and Presentment warranties
      - Bank’s option not to pay stale-dated item
      - Customer’s obligation to report unauthorized signatures
      - Requirement to send or make available customer statement of account showing payment of items; or
        - Information sufficient to allow customer to reasonably identify items paid (item number, amount, and date of payment)

- Electronic Presentment: UCC mentions presentment of image or other information by agreement (4-110)
  - Agreement for electronic presentment: May be an agreement, clearing-house rule, or Federal Reserve regulation or operating circular
    - Presentment of item may be by transmission of image of item or information describing item (“presentment notice”) rather than delivery of item itself
    - Agreement may provide procedures governing retention, presentment, payment, dishonor and other matters that are subject to the agreement
  - Note: See section below on Regulation CC for current definition of electronic check, electronic returned check and related warranties

- When Bank May Charge Customer’s Account
  - May charge for properly payable item even though:
    - Charge creates an overdraft;
    - Payment was made before the check date (postdated item)
      - Unless customer provided timely notice to bank of the postdating

- Stale dated: UCC states bank is under no obligation to customer having a checking account to pay a check (other than a certified check) that is presented more than six months after its date
  - May choose to charge its customer’s account but not obligated to do so

- Transfer and Presentment Warranties
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For UCC Article 4 Transfer and Presentment Warranties (4-207 and 4-208), see part “G. Warranties and Indemnification” in this section for details

3. Regulation CC – Availability of Funds and Collection of Checks

Overview and Purpose: Issued by the Board of Governors of the Federal Reserve System to implement the Expedited Funds Availability Act (EFA Act) and the Check Clearing for the 21st Century Act (Check 21 Act), the regulation contains four subparts and six appendices.

Recent updates created a regulatory framework for the collection and return of electronic items (i.e., electronic images and electronic information derived from a paper item) by defining the terms “electronic check” and “electronic returned check,” by creating Check-21-like warranties for electronic checks and electronic returned checks, and by applying existing paper-check warranties to electronic checks and electronic returned checks

• Subpart A – General authority and purpose of the regulation, general organization and the definitions and administrative enforcement provisions

• Subpart B – Availability of Funds and Disclosure of Funds Availability Policies: Rules regarding the duty of banks to make funds deposited into accounts available for withdrawal, including availability schedules, exceptions to the schedules, disclosure of funds availability policies and payment of interest
  – Note: Subpart B was not updated in 2018; under the joint authority of the Federal Reserve Board and the Bureau of Consumer Financial Protection (commonly referred to as the CFPB). A proposal for updates to Subpart B, with request for comments from the industry, was announced at the end of 2018.

• Subpart C – Collection of Checks: Rules to expedite the collection and return of checks and electronic checks by banks including the direct return of checks and electronic checks by banks, the manner in which the paying bank and returning banks must return checks and electronic checks to the depositary bank, notification of nonpayment by the paying bank, indorsement and presentment of checks and electronic checks and same-day settlement for certain checks

• Subpart D – Substitute Checks: Rules relating to substitute checks, the creation and legal status of substitute checks, warranties and indemnity, expedited recredit procedures for resolving improper charges and warranty claims associated with substitute checks provided to consumers; disclosure requirements and notices that banks must provide

• Following is an outline of key provisions in each of these four subparts. For more detail on Regulation CC, including the most recent updates effective Jul-2018 and Jan-2019, download the complete regulation available here: https://www.federalreserve.gov/supervisionreg/reglisting.htm
  – Subpart A: General – Outlines the authority and purpose of the regulation issued by the Board of Governors of the Federal Reserve System to implement the Expedited Funds Availability Act (EFA Act) and the Check Clearing for the 21st Century Act (Check 21 Act); includes the following definitions: note: listed here alphabetically and not in order as updated in Reg CC; not an all-inclusive list)
    Account
    o Generally, includes accounts at a bank from which account holder may make transfers or withdrawals by negotiable instrument, payment order of
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withdrawal, telephone transfer, electronic payment, or other similar means
for the purpose of making payments or transfers to third persons or others
  o Examples include demand deposit account (DDA) or share draft account
– Available for withdrawal
  o Available for all uses permitted to customer for actually and finally collected
    funds under bank’s account agreement or policies
– Bank includes:
  o Insured bank
  o Mutual savings bank
  o Savings bank
  o Insured credit union
  o Member as defined in section 2 of the Federal Home Loan Bank Act
  o Savings association
  o Agency or a branch of a foreign bank as defined in section 1(b) of the
    International Banking Act
– Banking day - Business day on which office of bank is open to public for
  substantially all banking functions
– Business day - Calendar day other than a Saturday or a Sunday, or Federal
  Reserve legal holidays
– Cashier’s check – drawn on a bank and signed by an officer or employee of the
  bank on behalf of the bank as drawer; a direct obligation of the bank that is
  provided to a customer of the bank or acquired from the bank for remittance
  purposes
– Check - Negotiable demand draft that is:
  o Drawn on or payable through or at office of bank
  o Drawn on Federal Reserve Bank or Federal Home Loan Bank
  o Drawn on the Treasury of the United States
  o Demand draft drawn on a state government or unit of general local
    government not payable through or at a bank
  o United States Postal Service money order; or
  o Traveler’s check drawn on or payable through or at a bank
  o Includes original check and substitute check
  o Does not include noncash item or an item not payable in US funds
– Depositary Bank - First bank to which check is transferred even though it may
  also be paying bank of payee
– Electronic check and electronic returned check - An electronic image of, and
  electronic information derived from a paper check or paper returned check,
  respectively, that:
  o Sent to a receiving bank pursuant to an agreement between the sender and
    receiving bank; and
  o Conforms with ANS X9.100-187 standard
– Electronically-created item - Electronic image that has all the attributes of an
  electronic check or electronic returned check but was created electronically and
  not derived from a paper check
– Forward collection - process by which a bank sends a check on a cash basis to
  a collecting bank for settlement or to the paying bank for payment
– Indemnifying Bank - Bank that provides an indemnity with respect to:
  o Remote deposit capture or an electronically-created item, or
  o A substitute check
– Noncash item - Item that would otherwise be a check, except:
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- Passbook, certificate or other document attached
- Accompanied by special instructions, such as request for special advice of payment or dishonor
- Consists of more than a single thickness of paper, except a check that qualifies for handling by automated check processing equipment; or
- Not preprinted or post-encoded in magnetic ink with the routing number of the paying bank

- Paying Bank - Bank by which a check is payable and to which it is sent for payment or collection; may also be:
  - Federal Reserve Bank or Federal Home Loan Bank by which a check is payable;
  - Bank through which a check is payable, if the check is not payable by a bank; or
  - State or unit of general local government on which a check is drawn and to which it is sent for payment or collection

- Reconverting Bank - Bank that creates a substitute check; or for a substitute check created by a non-bank
  - First bank that transfers, presents, or returns that substitute check

- Remotely Created Check - Check not created by the paying bank
  - Does not bear a signature applied, or purported to be applied, by the person on whose account the check is drawn

- Returning Bank - Bank (other than paying or depositary bank) handling a returned check or notice in lieu of return
  - Also, a collecting bank for purposes of UCC 4–202(b)

- Routing number - Number printed on the face of a check in fractional form on in nine-digit form; or number in a bank's indorsement in fractional or nine-digit form; or for purposes of subpart C and subpart D, the bank-identification number contained in an electronic check or electronic returned check

- Substitute check - Check as defined under Reg CC; the substitute check:
  - Contains image of front and back of check, is suitable for automated processing and conforms to industry standards for MICR and the physical characteristics of a check
  - Substitute Check is legal equivalent of original check for all purposes, including any provision of federal or state law if it:
    - Accurately represents all information on original check; and
    - Contains the legal legend that reads, “This is a legal copy of your check. You can use it the same way you would use the original check”

- Sufficient Copy and Copy
  - *Sufficient copy*: Copy of an original check that accurately represents all information on front and back of the original check at the time it was truncated; or is
    - Sufficient to determine whether a claim is valid
  - Copy of original check: Paper reproduction of an original check, including:
    - Paper printout of electronic image of original check
    - Photocopy of original check, or
    - Substitute check, or
    - Any electronic reproduction of a check that recipient has agreed to receive from sender instead of a paper reproduction
- Truncating bank – Bank that removes the original check from the check collection process; or if a non-bank removes original check:
  o First bank that transfers, presents, or returns the substitute check in lieu of original check

- Subpart B – Availability of Funds and Disclosure of Funds Availability Policies; key provisions include:
  
  o Next day Availability - Generally, a depositary bank shall make funds deposited available for withdrawal not later than the business day after the banking day of deposit for:
    o Cash deposits, if deposit is made in person at the depositary bank;
    o Electronic payments
    o Certain check deposits including:
      • Check drawn on the Treasury of the United States
      • US Postal Service money order
      • Check drawn on a Federal Reserve Bank or Federal Home Loan Bank
      • Check drawn by a state or a unit of general local government
      • Cashier’s, certified, or teller’s check
    o All other checks deposited at same depositary bank and lesser of:
      • $200 (or amount as adjusted for inflation every 5 years), or
      • Aggregate amount deposited on one banking day to all accounts by check not subject to next-day availability

  - Two-Day Availability: Depositary bank shall make funds available for withdrawal no later than second business day after the banking day on which checks deposited in person

  - Extension of Schedule – For deposits at nonproprietary ATMs
    o Depositary bank shall make funds available for withdrawal no later than fifth business day after the banking day on which checks deposited

  - Availability - Form of disclosures
    o Shall be clear and conspicuous in writing and must be in a form that the customer may keep;
      • Other than those posted at locations where employees accept consumer deposits, and
      • ATMs and the notice on preprinted deposit slips
    o Regulation requires disclosures be grouped together and not contain any information not related disclosures

  - Exceptions: Exceptions to next-day or two-day availability may include:
    o Deposits to new accounts: During first 30 days after account established;
    o Large deposits: May apply to aggregate deposits to all customer accounts;
    o Certain redeposited checks;
    o Accounts with repeated overdrafts: Repeatedly overdrawn for a period of six months; may consider an account to be repeatedly overdrawn if:
      • Six or more banking days within preceding six months, account balance is negative or would have become negative if checks or other charges to the account had been paid; or
      • Two or more banking days within preceding six months, account balance is negative, or the account balance would have become negative, in the amount of $5,000 or more, if checks or other charges to the account had been paid;
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- Reasonable cause to doubt collectability – Facts exist that would cause a reasonable person to believe check is uncollectible;
  - Reason to be included in the notice to customer
- Emergency conditions such as:
  - Interruption of communications, computers, other equipment or facilities;
  - Suspension of payments by another bank;
  - War or other emergency condition beyond bank’s control
  - Note: Subpart B is under the joint jurisdiction of the Federal Reserve Board of Governors and the Bureau of Consumer Financial Protection (CFPB). This subpart of Regulation CC was not updated in the 2018 release of final amendments to Regulation CC
- Subpart C – Collection of Checks; includes requirements for each bank in the collection process and specific warranties
  - Electronic checks and electronic returned checks are subject to this subpart as if they were checks or returned checks, unless “paper check” or “paper returned check” is specified
    - Term “check” or “returned check” as used in Subpart A includes “electronic check” or “electronic returned check,” except where “paper check” or “paper returned check” is specified
  - Writings - If bank is required to provide information in writing, may satisfy that requirement by providing the information electronically if the receiving bank agrees
  - Paying Bank: Return of checks and notices of nonpayment
    - May send a returned check, subject to expeditious return requirements, to depositary bank or to any other bank agreeing to handle returned check
    - If unable to identify the depositary bank, may send returned check to any bank that handled the check for forward collection and advise that the paying bank is unable to identify the depositary bank
      - Expeditious return requirements do not apply to paying bank’s return in this case
  - Expeditious Return of Checks: if paying bank determines not to pay a check, it must return the check in an expeditious manner such that check would normally be received by depositary bank not later than 2:00 p.m. (local time of the depositary bank) on the second business day following the banking day on which the check was presented to the paying bank
  - Identification of Returned Check – Paying bank must clearly indicate on the front of the check that it is a return and reason for return
    - If returning a substitute check or an electronic returned check, paying bank must include information such that the information would be retained on any subsequent substitute check
  - Notice in lieu of return: If the check unavailable for return, paying bank may:
    - Send copy of the front and back of returned check
    - Written notice of nonpayment containing the information
    - Copy or notice clearly state it constitutes notice in lieu of return
    - Considered a returned check subject to the expeditious return requirements
      - Note: May be referred to as a “sorry” document
Reliance on Routing Number: Paying Bank may return a check based on any routing number designating depositary bank appearing on returned check in depositary bank’s indorsement

Notice of Non-Payment: If Paying Bank determines not to pay check $5,000 or more:
- Must provide notice of nonpayment to depositary bank by 2:00 p.m. (local time) on second business day following the banking day on which check was presented
- Notice may be provided by any reasonable means including the returned check
- Content of Notice: To the extent available, paying bank must include:
  - Information from check’s MICR line when check was received by paying bank, and
  - Name of the payee(s), amount, date of depositary bank indorsement, bank name, routing number, trace or sequence number associated with depositary bank’s indorsement and reason for nonpayment

Returning Bank – Return of Checks
- Same requirements for expeditious return as the Paying Bank
- Same requirements/process for unidentifiable depositary bank
  - Any collecting bank that handled check for forward collection if returning bank not collecting bank with respect to returned check; or
  - Prior collecting bank, if the returning bank was a collecting bank with respect to returned check

Depositary Bank – Return of checks and notices of nonpayment:
- Right to assert claim: Paying bank or returning bank may be liable to depositary bank for failing to return a check in an expeditious manner only if depositary bank has arrangements to receive returns electronically, directly or indirectly, by commercially reasonable means
  - If claim for late return is asserted, depositary bank has the burden of proof to show arrangements are commercially reasonable
- Acceptance of electronic returned checks and electronic notices of nonpayment: by agreement with the transferor bank
- Acceptance of paper returned checks and paper notices of nonpayment: At location designated by the depositary bank in its indorsement for presentment of checks for forward collection
  - Depositary bank may require paper returned checks be separated from paper forward collection checks
- Acceptance of oral notices of nonpayment: Accept oral notices of nonpayment during its banking day at telephone number indicated in the indorsement; and at any other number identified for receipt of notice of nonpayment
- Payment: Must pay the returning or paying bank for amount of check prior to the close of business on the banking day on which check was received
  - Debit the settlement account of depositary bank by cash, wire transfer, or any other form of payment acceptable to returning or paying bank
  - Payments are final when made
- Misrouted returned checks or written notice of nonpayment:
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• Must “expeditiously” send the returned check or notice directly to the depositary bank or to a returning bank agreeing to handle the returned check, or to the bank from which it was received
  o Charges: Depository bank may not impose a charge for accepting and paying checks being returned to it
  o Notification to customer: If depositary bank receives returned check or notice of nonpayment, must send or give notice to its customer of the facts by midnight of the banking day following the banking day on which it received the returned check or notice

– Warranties and Indemnities – Electronic checks and electronic returned checks
  o Each bank that transfers or presents an electronic check or electronic returned check, and receives a settlement or other consideration, warrants:
    • Electronic image accurately represents all information on front and back of original check at time of truncation, and
    • Electronic information includes an accurate record of all MICR line information required for substitute check and amount of the check, and
    • No person will be charged for an electronic check or electronic returned check, the original check, a substitute check, or paper or electronic representation of a substitute check such that the person will be asked to make payment based on a check it has already paid (commonly referred to as the no double-debit or no “duplicates” warranty)
  o Each bank that makes these warranties provides warranties to:
    • If transfer for collection or presentment: Warranties extend to the transferee bank, any subsequent collecting bank, the paying bank, and the drawer;
    • If transfer for return: Warranties extend to the transferee returning bank, any subsequent returning bank, the depositary bank, and the owner

– Transfer and presentment warranties - Remotely Created Checks
  o Bank that transfers or presents remotely created check and receives settlement, warrants to transferee bank, any subsequent collecting bank and the paying bank that the person on whose account the check is drawn:
    • Authorized issuance of the check;
    • In amount stated on check and to payee stated on check
    • If paying bank asserts a claim for breach of warranty, the warranting bank may defend, if applicable, by proving paying bank’s customer is precluded from asserting the claim under UCC 4–406 (Customer’s Duty to Discover and Report Unauthorized Signature or Alteration)

– Warranty of Settlement Amount, Encoding, and Offset
  o Settlement Amount:
    • Each bank that presents one or more checks and receives settlement or other consideration warrants:
      ✓ Total amount of checks presented is equal to total amount of settlement demanded by the presenting bank
    • Each bank that transfers one or more checks or returned checks and receives settlement or other consideration warrants
      ✓ Accompanying information accurately indicates total amount of checks or returned checks transferred
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- Encoding Warranty:
  - Each bank that presents or transfers a check or returned check warrants that at the time of presentment:
    - Information encoded after issue regarding the check or returned check is accurate
    - Information encoded after issue means information that could be encoded in the MICR line of a paper check
  - Includes any information placed in the MICR line of substitute check

- Offset Warranty:
  - For banks that settle amounts exceeding total amount of checks, the settling bank may offset the excess settlement amount against future/subsequent settlements

- Returned check warranties
  - Each paying bank or returning bank that transfers a returned check and receives a settlement of other consideration warrants that it:
    - Returned the check within its UCC midnight deadline
    - Authorized to return check
    - Check not materially altered
    - For notice in lieu of return, check has not and will not be returned

- Warranty - Notice of nonpayment
  - Paying bank warrants:
    - Check is returned or will be returned within the UCC midnight deadline
    - Authorized to send the notice; and
    - Check has not been materially altered

- Note: Returned check and Notice of Nonpayment warranties are not made on checks that are:
  - Drawn on US Treasury, or
  - Drawn on a state or a unit of general local government that are not payable through or at a bank; or
  - U.S. Postal Service money orders

- Remote deposit capture (RDC) Indemnity
  - Indemnity is provided by a depositary bank that is:
    - Truncating bank because it accepts deposit of an electronic image or other electronic information related to original check;
    - Does not receive the original check;
    - Receives settlement or other consideration for an electronic check or substitute check related to the original check; and
    - Does not receive a return of the check unpaid
  - Indemnity is provided to the depositary bank that:
    - Accepted the original check
    - Incurred a loss if the loss is due to the check having already been paid
    - Original check did not have a restrictive indorsement that is inconsistent with the means of deposit
  - Paper Deposit bank may not make an indemnity claim if original check it accepted for deposit bore a restrictive indorsement inconsistent with the means of deposit

- Indemnities with respect to electronically-created item (ECI)
  - Indemnity is provided by: Each bank that transfers or presents an ECI and receives a settlement or consideration for it
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- Indemnity is provided to: Transferee bank(s), any subsequent collecting bank, the paying bank, and any subsequent returning bank against losses that result from the fact:
  - Electronic image or electronic information is not derived from a paper check;
  - Person on whose account the ECI is drawn did not authorize the issuance of the item in the amount or to payee stated on the item;
  - Person receives a transfer, presentment, or return of, or otherwise is charged for an ECI based on an item or check it has already paid.

- Other Warranty Provisions
  - Damages for breach of warranties: Shall not exceed amount of item plus interest compensation and expenses
  - Indemnity amounts. Amount of damages for RDC Indemnity or ECI Indemnity claims shall not exceed the sum of:
    - Indemnified bank’s loss, up to amount of settlement or other consideration received by the indemnifying bank, plus interest and expenses including costs and reasonable attorney’s fees
    - May have other rights under UCC or applicable state or federal law
  - Tender of defense: May give prior bank in collection or return chain written notice of litigation
  - Notice of claim: Must be made within 30 days after claimant has reason to know of breach and identity of warranting bank
    - Warranting bank discharged to the extent of any loss caused by the delay in giving notice of the claim

- Indorsements
  - Indorsement Standards: A bank (other than a paying bank) that handles a check during forward collection or a returned check must indorse the check
    - Must be indorsed in a manner that permits a person to interpret the indorsement, and
    - In accordance with American National Standard (ANS) standards for:
      ✓ Paper check (other than a substitute check): ANS X9.100-111;
      ✓ Substitute check (IRD): ANS X9.100-140
      ✓ Electronic check: ANS X9.100-187
  - Liability of bank handling check: Bank that handles a check for forward collection or return is liable to any bank that subsequently handles check to the extent that subsequent bank does not receive payment for the check
    - Applies whether or not a bank has placed its indorsement on the check
  - Indorsement by a bank: After check indorsed by bank, only bank may acquire the rights of a holder:
    - Until the check has been returned to person initiating collection, or
    - Until the check has been specifically indorsed to person who is not a bank; for example:
      ✓ Bank accepts an item (returned check or over the counter) and cannot collect; Bank is holder of the item
      ✓ Bank may choose to assign the check to non-bank entity to attempt collection; Non-bank entity becomes the holder
  - Indorsement for depositary bank: May arrange with another bank to apply the other bank’s indorsement as depositary bank indorsement
• Must avoid area reserved for depositary bank indorsement as specified in the indorsement standard applicable to the check;
• Other bank indorsing as depositary bank is considered the depositary bank for purposes of subpart C
• Example: May be used in a centralized return environment

– Presentment and issuance of checks
  o Receipt of electronic checks: Terms under which paying bank will accept presentment of an electronic check is governed by agreement
  o Receipt of paper checks. Paper check is considered received by the paying bank when it is received at:
    • Location to which delivery is requested by the paying bank;
    • Address of bank associated with the routing number on the check;
    • Branch, head office, or other location of the bank on the check; or
    • Bank may require checks presented for forward collection be separated from returned checks

– Liability of bank during forward collection
  o Settlement between banks for forward collection of a check is final when made
    • Collecting bank handling a check for forward collection may be liable to a prior collecting bank including the depositary bank and the depositary bank’s customer

– Same-Day Settlement
  o Paper check is considered presented, and a paying bank must settle for or return the check if presenting bank delivers the check under delivery requirements established by the paying bank and demands payment:
    • At a location designated by the paying bank for receipt of paper checks
    • By 8 a.m. on a business day (local time)
  o Paying bank may require that paper checks presented for same-day settlement be separated from other forward-collection checks or returned checks
  o If presentment of a paper check meets these requirements:
    • Paying bank is accountable to presenting bank for amount of the check unless, by the close of Fedwire on the business day it receives the check, it:
    • Setslles with the presenting bank for the amount of the check by credit to an account at a Federal Reserve Bank designated by the presenting bank; or
    • Returns the check

– Variation by agreement
  o Effect of provisions of subpart C may be varied by agreement, except
    • No agreement can disclaim the responsibility of a bank for its own lack of good faith or failure to exercise ordinary care

– Liability - Standard of care; liability; measure of damages
  o Bank must exercise ordinary care and act in good faith in complying with subpart C; otherwise may be liable to depositary bank, depositary bank’s customer, owner of a check, or another party to the check
  o Measure of damages for failure to exercise ordinary care: 52
• Amount of the loss incurred, up to the amount of the check; may be reduced by amount of loss that would have occurred even if bank had exercised ordinary care
  o Measure of damages for failure to act in good faith:
    • May be liable for consequential damages
– Paying bank’s failure to make timely return
  o Failure to comply with expeditious return requirements and the deadline for return under UCC, paying bank liable under either provision, but not both
– Comparative negligence
  o If a person, including a bank, fails to exercise ordinary care or act in good faith in indorsing a check, accepting a returned check or a notice of nonpayment, damages incurred may be diminished in proportion to the amount of negligence or bad faith attributable to that person
– Presumption of Alteration (effective Jan 1, 2019)
  o In absence of other Federal statute or regulation to the contrary, the presumption applies to disputes between banks as to whether a substitute check or electronic check transferred between those banks:
    • Contains an alteration; or
    • Is derived from an original check that was issued with an unauthorized drawer signature
  o Presumption may be overcome by proving by a preponderance of evidence to the contrary
  o If original check is made available for examination by all banks involved in the dispute, this presumption would no longer apply
  o Provision does not alter UCC transfer and presentment warranties that allocate liability with respect to item that has been altered or that was issued with an unauthorized signature
    • See UCC 3-407 and UCC 1-201 and 3-403 for details
– Relation to State law
  o Provisions of subpart C supersede UCC as adopted in any state, or of any other state law, but only to the extent of the inconsistency between the rules
– Exclusions: Expeditious return, notice of nonpayment, and same-day settlement requirements in Subpart C do not apply to a check:
  o Drawn upon the United States Treasury;
  o U.S. Postal Service money order;
  o Drawn on a state or a unit of general local government that is not payable through or at a bank
    • See Reg §229.42 and commentary for additional details
• Subpart D - Substitute Check
  – Negotiable instrument created by the Check 21 Act
  – Must accurately represent all of the information on the front and back of the original check when original check was truncated; and must bear the legend, “This is a legal copy of your check. You can use it the same way you would use the original check.”
  – Properly prepared substitute check is the legal equivalent of the original item for all purposes including any provision of federal or state law
  – Reconverting bank duties:
    o Ensure substitute check for which it is the reconverting bank:
• Bears all prior indorsements of parties that previously handled check for forward collection or return;
• Identified in manner that preserves any previous reconverting-bank identifications, in accordance with ANS X9.100-140 standard; and
• Identifies the bank that truncated the original check, in accordance with ANS X9.100-140

- Substitute check warranties:
  o Applies to all substitute checks
  o Financial institution that creates substitute checks warrants the substitute check:
    • Meets all requirements for legal equivalency; and
    • There will be no double debit
  o Bank makes these warranties to:
    • The person to which the bank transfers, presents, or returns the substitute or a paper or electronic representation of such substitute check, and to any subsequent recipient;
    • Parties receive the warranties regardless of whether they received the substitute check or a paper or electronic representation of a substitute check

- Substitute check Indemnity: Bank that creates substitute check and each subsequent financial institution indemnifies all parties for loss, if loss is due to receipt of substitute check
  o Consequential damages rests with the financial institution that creates the substitute check
  o If breach of warranty, financial institution that creates the substitute check can limit liability, if it produces original check or a copy of the original check on request
  o Liability provisions of Check 21 Act have established a one-year statute of limitations for claims

- Check 21 Expedited Recredit for Consumers
  o Consumer has 40 calendar days from the statement date, or receipt of the substitute check that gave rise to the loss, to make the claim
  o If the claim is less than $2,500:
    • Paying Bank has 10 business days to make the funds available plus interest on that amount if the account is an interest-bearing account
  o If the claim is greater than $2,500:
    • Paying Bank must make the remainder of the funds available within 45 calendar days
  o Paying bank must make claim to the Reconverting Bank (bank that created the substitute check)
    • Within 120 days of transaction that gave rise to claim
  o Reconverting bank must provide recredit, original check or copy
    • Within 10 days of Paying Bank claim

- Consumer Awareness – Disclosures
  o Describe that the substitute check is the legal equivalent of an original check
  o Describe what the consumer recredit rights are that apply when a consumer in good faith believes that substitute check was not properly charged to account
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Disclosure required to consumers who:
• Receive paid checks with periodic account statements
• Receive substitute checks on an occasional basis:
  ✓ Example: When the financial institution returns a substitute check to depositing customer (return item i.e. NSF)
• Provide disclosure to consumer customer who requests original or copy of check and receives a substitute check
  • At the time of the request
  • When substitute check is provided

Appendices:
- Appendix A – Routing Number Guide To Next-day Availability Checks And Local Checks
- Appendix B – Reserved
- Appendix C – Model Availability Policy Disclosures, Clauses, And Notices; Model Substitute Check Policy Disclosure And Notices
- Appendix D – Reserved
- Appendix E – Commentary
- Appendix F – Official Board Interpretations; Preemption Determinations

4. Regulation J - Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers Through Fedwire

NOTE: The Regulation J provisions outlined here are based on provisions currently in effect at the time this Guide was published. An overview of the final amendments to Regulation J, released late last year and effective January 1, 2019, are listed separately in this section. Since Regulation J and Fed OC 3 are interdependent, and updates to Federal Reserve Operating Circular 3 (OC 3) were not available when this Guide was published, only the 2018 effective versions for both Regulation J and OC 3 are covered in this Guide, NCP training and on any related question on the 2019 NCP Exam.

Issued by the Board of Governors of the Federal System, pursuant to the Federal Reserve Act, the Expedited Funds Availability Act, the Check Clearing for the 21st Century Act and other laws

- Subpart A governs collection of checks and other items by Reserve Banks (FRBs) and includes warranties and indemnities given to FRBs by parties that send items for collection and return via FRBs, the warranties and indemnities FRBs give in connection with the items they handle, and method by which FRBs may recover for losses associated with their collection of items
- Authorizes operating circulars that govern the details of collection of checks and other items which have a binding effect on all parties with an interest in item
  - See Operating Circular 3 “Collection of Cash Items and Returned Checks”
- Subpart B of Regulation J provides rules to govern funds transfers through the Reserve Banks’ Fedwire Funds Service that is also governed by FRBs Operating Circular No. 6 “Funds Transfers through the Fedwire Funds Service”
- In addition to an overview of the authority purpose and scope of Regulation J, Subpart A includes the following: (not all-inclusive):
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- **Definitions**
  - Account
  - Administrative Reserve Bank
  - Bank
  - Bank draft
  - Banking day
  - Cash item
  - Check
  - Item and electronic item
  - Nonbank payor
  - Noncash item
  - Paying Bank
  - Returned Check
  - Sender

- **General provisions**
  - Reserve Bank shall:
    - Receive and handle items in accordance with this subpart
    - Issue operating circulars governing details of handling of item
  - Binding effect – this section, subparts C and D of Reg CC and operating circulars are binding on all parties with interest in items handled by Reserve Bank

- **Sending items to Reserve Banks**
  - Sender other than a Reserve Bank may send any item to any Reserve Bank
  - Handling of items: by parties including initial sender, initial sender’s administrative Reserve Bank and Reserve Bank that receives the item from the initial sender

- **Sender’s agreement; recovery by Reserve Bank**
  - Sender may not disclaim warranties, authorizations or agreements made to the Reserve Bank

- **Status, warranties and liability of Reserve Bank**
  - Reserve Bank that handles an item shall act as agent or subagent of the owner until Reserve Bank receives final payment for the item
  - Limitations on Reserve Bank liability: Reserve Bank assumes no liability for item except for the Reserve Bank’s own lack of good faith or failure to exercise ordinary care

- **Presenting items for payment**
- **Presenting noncash items for acceptance**
- **Settlement and payment**
- **Time schedule and availability of credit for cash items and returned checks**
- **Availability of proceeds of noncash items; items schedule**
- **Return of cash items and handling of returned checks**
- **Unpaid items**
- **Extension of time limits**
- **Direct presentment of certain warrants**

- Subpart B provides rules to govern funds transfers through Fed wire and has been issued pursuant to the Federal Reserve Act and other laws and has the force and effect of federal law. Subpart B incorporates the provisions of Article 4A of the UCC and it governs the rights and obligations of:
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- Federal Reserve Banks sending and receiving payment orders
- Senders that send payment orders directly to a Federal Reserve Bank
- Receiving banks that receive payment orders directly from a Federal Reserve Bank
- Beneficiaries that received payment for payment orders sent to a Federal Reserve Bank by means of credit to an account maintained or used at a Federal Reserve Bank
- Other parties to a funds transfer any part of which is carried out through Fedwire to the same extent as if Subpart B were considered a fund-transfer system rule under Article 4A of the UCC

5. Overview of Regulation J Final Amendments (eff. January 1, 2019)

Following is an overview of updates to Regulation J that were released November 15, 2018 to be effective January 1, 2019. Regulation J will now:

- Align with Regulation CC amendments addressing Electronic Checks
  - Align subpart A of Regulation J to final amendments to Reg CC and incorporate certain provisions by reference to reduce duplication between the regulations
    - “Electronic item” definition removed
    - “Check” and “Returned check” defined to include an electronic check and electronic returned check as defined in Reg CC
    - “Item” also defined to include an electronic check as defined in Reg CC
    - Remove Check-21-like warranties currently provided under Regulation J by the sender and the Reserve Banks; Regulation J now states the sender of an item (including an electronic check) and the Reserve Banks would make all the warranties and indemnities set forth in and subject to subparts C and D in Reg CC

- Address Electronically Created Items
  - Amend definition of “item” in subpart A of Regulation J to explicitly state that the term does not include an ECI as defined Reg CC
  - Reserve Banks to require senders to provide warranties and indemnities that only “items” and any “noncash items” the Reserve Banks have agreed to handle will be provided to the Reserve Banks
  - Reserve Bank provide subsequent collecting bank and paying bank with warranties and indemnities provided by the sender
    - Aligns with Reg CC to help shift the liability for ECIs to parties better positioned to know whether an item is electronically created and to prevent it from entering the check-collection system

- Revise settlement and payment provisions
  - For certain settlements that reference cash and other specified forms of settlement (e.g., cashier’s checks or certified checks) to instead state that the Reserve Banks may settle by a debit to an account on the Reserve Bank’s books, or another acceptable form of settlement

- Clarify Legal Status of Terms for financial messaging standards
  - States that terms used in financial messaging standards, such as ISO 20022, do not confer or connote legal status or responsibilities

- Remove obsolete provisions
6. Regulation E – Electronic Funds Transfer

- Reg E carries out the purposes of the Electronic Fund Transfer Act (EFTA)
- Primary objective of the act is the protection of individual consumers engaging in electronic fund transfers
- Establishes the basic rights, liabilities, and responsibilities of:
  - Consumers who use electronic fund transfer services, and Financial institutions that offer these services
- Reg E applies to electronic fund transfers (EFTs) from and to an account established for personal, family or household purpose
  - Corporate accounts not subject to Reg E
    - Consumer accounts only

Note: “Subpart A” and “Subpart B” refer to the revised regulation that now falls under the Consumer Financial Protection Bureau (CFPB) as “Remittance Rule” Section 1005. For more information, visit the CFPB website at: http://www.consumerfinance.gov/remittances-transfer-rule-amendment-to-regulation-e/

- Reg E requires that customer request issuance of Access Devices by Financial Institution
- Initial Disclosure of Terms and Conditions
  - Bank must provide initial disclosures to consumer containing certain information before first EFT or time consumer contracts for service
  - Disclosure must include:
    - Summary of consumer’s liability for unauthorized transfers
    - Telephone number and address to notify in event of loss or unauthorized use
    - Banks’ business days
    - Charges for EFTs
    - Type of permissible EFTs
    - Summary of consumer’s right to receive documentation of EFTs
    - Summary of consumer’s stop payment rights
    - Summary of banks’ liability for failure to make or stop certain EFTs
    - Circumstances under which bank will disclose information to third parties
    - Information on error resolution
  - Disclosures could be made at time it obtains customer agreement to participate in program
- An electronic funds transfer is defined as:
  - Any transfer of funds initiated through an electronic terminal, telephone, computer, or magnetic tape for the purpose of ordering, instructing, or authorizing a financial institution to debit or credit a consumer’s account
- Types of electronic funds transfer includes but is not limited to:
  - Point-of-sale transfers
  - Automated teller machine transfers
  - Direct deposits or withdrawals of funds
  - Transfers initiated by telephone
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- Transfers resulting from debit card transactions, whether or not initiated through an electronic terminal

- Authorization
  - When converting a paper check or other paper instrument, the paper item is used as a source of information to initiate a one-time electronic fund transfer from a consumer's account. The consumer must authorize the transfer.
    - Examples: ACH e-check conversion options such as a POP (Point-of-Purchase) or a BOC (Back-Office-Conversion) transaction. Person initiating an electronic fund transfer using the consumer's check as a source of information for the transfer must provide a notice that the transaction will or may be processed as an electronic fund transfer, and obtain a consumer's authorization for each transfer
    - See ACH check conversion definitions for further details
  - Preauthorized electronic fund transfer – Consumer authorizes in advance to recur at substantially regular intervals

- Notification
  - One-time electronic fund transfer: Consumer provides a check to a merchant or other payee for the MICR encoding that includes the routing number of the financial institution, the consumer's account number and the serial number.
    - Notification occurs when the consumer receives notice and goes forward with the underlying transaction
  - Point-of-sale transfers
    - Notice must be posted in a prominent and conspicuous location, and a copy thereof, or a substantially similar notice, must be provided to the consumer at the time of the transaction

- Disclosures
  - Disclosures must be clear and readily understandable, in writing, and in a form the consumer may keep.
  - Disclosures may be provided to the consumer in electronic form, subject to compliance with the consumer consent and other applicable provisions of the Electronic Signatures in Global and National Commerce Act (E-Sign Act).
  - Financial institution may use commonly accepted or readily understandable abbreviations in complying with the disclosure requirements.

- Exclusions: Items not covered under Reg E, Electronic funds transfer does not include:
  - Checks – Transfer of funds originated by check, draft, or similar paper instrument; or any payment made by check, draft, or similar paper instrument at an electronic terminal
  - Check guarantee or authorization – Transfer of funds that guarantees payment or authorizes acceptance of a check, draft, or similar paper instrument but that does not directly result in a debit or credit to a consumer's account
  - Wire / Similar transfers – Transfer of funds through Fedwire or through a similar wire transfer system that is used primarily for transfers between financial institutions or between businesses
  - Securities and commodities transfers - Transfer of funds the primary purpose of which is the purchase or sale of a security or commodity
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- Automatic transfers by account-holding institution – Transfer of funds under an agreement between a consumer and a financial institution which provides that the institution will initiate individual transfers without a specific request from the consumer
- Telephone-initiated transfers – Transfer of funds: (i) initiated by a telephone communication between a consumer and a financial institution making the transfer that does not take place under a telephone bill-payment or other written plan in which periodic or recurring transfers are planned
- Small institutions – Preauthorized transfer to or from an account if the assets of the account-holding financial institution were $100 million or less on the preceding December 31

• Change in Terms; Error-Resolution Notice
- Bank who plans to change terms of its agreement relating to EFTs must provide notice to consumer 21 days before effective date, if change would adversely affect consumer
- Error resolution notice must be made to consumer once a year
  o How consumer contacts bank in event of an error

• Terminal Receipts
- Requires certain information be available to the consumer at the time an EFT is initiated at an “electronic terminal”
- Terminal receipts do not have to be provided if EFT is initiated at telephone or by means analogous to function of telephone, such as facsimile machine or home banking equipment because these EFTs are not initiated at an “electronic terminal”

• Periodic Statement
- Requires certain information be provided in the periodic statements sent to consumers by bank that holds the account
- Must be sent monthly if an EFT occurred
- Must include:
  o Amount, date, type of transfer and account, address of terminal (if applicable), name of any third-party payee, beginning and ending balances on account, amount of EFT fees or charges and address and phone number of bank for errors

• Pre-authorized (Recurring) Transfers
- Prescribes detailed rules governing pre-authorized transfers (also known as recurring transfers)
  o Requires that bank provide notice that transfer has occurred
  o Written or electronic authorization by consumer to merchant initiating the recurring transaction
  o Consumers right to stop payment at the bank
  o Prior notice of pre-authorized transfers varying in amount

• Procedure for Resolving Errors
- Sets forth certain procedures for bank to follow when resolving error alleged by consumer
- Error means:

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- Unauthorized EFT
- Incorrect EFT to or from account
- Omission from periodic statement of EFT to or from account that should have been included
- Computational or bookkeeping error
- Consumers’ receipt of incorrect amount from terminal
- EFT not identified in accordance with Reg E and request for additional documentation regarding EFT
  - Consumer must notify bank within 60 days after periodic statement that first reflects error
    - Bank is required to investigate error and transmit results to consumer in 10 days
    - Bank has additional time to resolve error if it provisionally recredits consumer account
  - Reg E does not provide consumer’s bank any right of recovery from another bank or other party through return of EFT

- Record Retention
  - Requires any person to maintain evidence of compliance and Reg E records for not less than two years
  - Prescribes certain limits on liability of consumer in the event an unauthorized EFT results in debit to consumer’s account
    - Unauthorized is defined as transfer from consumer’s account by person other than consumer who has actual authority to initiate transfer
  - Under Reg E consumer liability could be $500 or less if the bank is notified within the 60-day periodic statement
  - For transactions occurring after this period, the consumer could have unlimited liability for additional unauthorized transactions

- Liability for failure to execute authorized transfers
  - Bank may incur liability if it fails to execute an authorized EFT as instructed by the consumer
    - Could include consequential damages
  - Bank would not be liable under certain conditions
    - NSF
    - Funds subject to legal process
    - Terminal has insufficient cash
    - Act of God
    - Technical malfunction
      - Only liable for actual damages if failure was not intentional and resulted in bona fide error

- Regulation E, amended to establish new rules governing remittance transfer providers
  - Implemented section 1073 of the Dodd-Frank Act
  - Requires remittance transfer providers to provide disclosures to senders of remittance transfers
    - Must give senders written pre-payment disclosure of information
    - Must provide written receipt
    - Provides for specific error resolution procedures
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- Subpart B (See §1005 – CFPB Requirements for Remittance Transfer)
  - Established by the Dodd-Frank Act for remittance transfers
    - New comprehensive consumer protection regime for remittance transfers sent by consumers in U.S. to individuals and businesses in foreign countries
  - For covered transactions sent by remittance transfer providers, new EFTA section generally requires:
    - (i) provision of disclosures prior to and at time of payment by sender for transfer
    - (ii) cancellation and refund rights
    - (iii) investigation and remedy of errors by providers
    - (iv) liability standards for providers for acts of their agents
  - This rule does not apply to international check collection
  - No additional information regarding this rule covered in this guide

7. Suggestions for Further Study

- Uniform Commercial Code (UCC) Article 3 - Negotiable Instruments; Article 4 - Bank Deposits and Collections
  www.law.cornell.edu/ucc

- Regulations – available online at the Electronic Code of Federal Regulations (e-CFR)
  http://www.ecfr.gov/
  - Regulation E (12 CFR Part 205)
  - Consumer Financial Protection Bureau (CFPB) - Remittance Rule Section 1005
  - Regulation J (12 CFR Part 210)
  - Regulation CC (12 CFR Part 229)

8. Review Questions

The following questions are a review of key points covered in this section and may be used to further aid in the study of these topics. See “Section Four – Exhibits - Exhibit 10” for the Answer Key.

- How is a negotiable instrument defined?
- What is a noncash item?
- What is another term for a “stale-dated check” and what is the bank’s responsibility under the UCC to pay such an item?
- In the case of an item with differing courtesy and legal amounts (contradictory terms), which amount prevails?
- What is the difference between a Holder and a Holder in Due Course?
- How did the Dodd-Frank Act amend the Expedited Funds Availability Act?
- What is a Notice of Nonpayment?
- What is the RDC Indemnity under provisions of Reg CC?
- What is the ECI Indemnity under provisions of Reg CC?
- Are electronically-created items eligible for exchange under ECCHO Rules or Fed OC 3?
G. WARRANTIES AND INDEMNIFICATION

Learning Objective: To fully understand the rules and regulations governing check exchange, it is helpful to understand the underlying warranties and indemnifications and the sources of each. This section will review those warranties and related indemnifications as they apply to the exchange of check payments. Each of the exhibits described in this section, and included at the end of this Guide, describes the warranties provided through Uniform Commercial Code (UCC) and Regulation CC, which apply to check payments regardless of the channel for exchange. Exchange channels may include private sector options where additional warranties may be provided by private sector clearing house rules, such as ECCHO Rules or other agreements. If the channel of exchange is the Federal Reserve Banks, the warranty provisions would be provided by Regulation J for those exchanges.

NOTE: Regulation J warranties and indemnities outlined in this section are based on provisions currently in effect at the time this Guide was published. Since Regulation J and Federal Reserve OC 3 are interdependent, and OC3 was also not available when this Guide was updated, only the 2018 effective versions for both Regulation J and Fed OC 3 are covered in this Guide, in the NCP Core Training program and any related questions on the 2019 NCP Exam. To see an outline of the warranties based on final amendments to Regulation J (eff. Jan-2019), please see the “Supplemental Warranties and Indemnities” tables following Exhibit 8 in this Guide.

1. Forward Exchange Warranties – Exhibit 5

- Outline of the warranty and/or other responsibility for the forward presentment item. Table also includes a short explanation of how the warranty applies to the banks and/or to the banks’ customer(s)

- Warranties shown in the summary in Exhibit 5 Include:
  - Regulation CC:
    - Transfer Warranties for Settlement Amount and Encoding
    - Presentment Warranties for Settlement Amount and Encoding
    - Transfer and Presentment Warranties for Remotely Created Checks
    - Transfer Warranties for Electronic Checks
    - Substitute Check Warranties
  - Uniform Commercial Code (UCC):
    - Transfer Warranties
    - Presentment Warranties
    - Encoding Warranty
  - ECCHO Operating Rules and Commentary including warranties for:
    - Sending Bank – Compliance with ECCHO Rules
    - Receiving Bank – Compliance with ECCHO Rules
    - Repair of Item
    - Forged and Counterfeit Check Warranties
  - Regulation J
    - Sender’s Warranties:
      - Regarding handling of the Item
      - For all Electronic Items; as set forth in UCC and Reg CC
      - For Electronic Items that are not representations of Substitute Checks
    - Reserve Bank’s Warranties:
      - Regarding the Item
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- For all Electronic Items; as set forth in UCC and Reg CC
- For Electronic Items that are not representations of Substitute Checks

2. Forward Exchange Indemnification – Exhibit 6

- Indemnity or other liability provisions shown in Exhibit 6 show the application in each case to the banks and/or customers and include:
  - Regulation CC Indemnities for:
    o Electronically Created Item (ECI)
    o Remotely Deposited Check (RDC)
    o Check 21 Substitute Check
  - ECCHO Operating Rules Indemnities for:
    o Sending Bank Breach of Warranty of Compliance with ECCHO Rules
    o Receiving Bank: Breach of Warranty of Compliance with ECCHO Rules
    o Sending Bank Responsibility for Check 21 Liability incurred by Receiving Bank
  - Regulation J Indemnities for:
    o Sender’s Breach of Warranties Regarding the Item
    o Reserve Bank’s Breach of Warranties Regarding the Item
    o Reserve Bank’s Certain Substitute Check Liability

3. Return Warranties – Exhibit 7

- Warranties and other responsibility for returned check, return substitute check and for electronic returned checks are included in this section
- Warranties shown in the table in Exhibit 7 include:
  - Regulation CC Warranties for:
    o Settlement Amount and Encoding
    o Returned Check
    o Notice of Nonpayment
    o Electronic Returned Check
    o Substitute Check
  - ECCHO Operating Rules Warranties for:
    o Returning Member – Compliance with ECCHO Rules
    o Returnee Member – Compliance with ECCHO Rules
  - Regulation J – Paying Bank or Returning Bank Warranties:
    o Regarding the returned check
    o For all returned checks that are Electronic Items; as set forth in UCC and Reg CC
    o For all returned checks that are Electronic Items that are not representations of Substitute Checks
  - Regulation J – Reserve Bank’s Warranties
    o Regarding the returned check
    o For all returned checks that are Electronic Items; as set forth in UCC and Reg CC
    o For all returned checks that are Electronic Items that are not representations of Substitute Checks
4. Return Indemnification – Exhibit 8
   - Indemnity or other liability provisions shown in the table in Exhibit 8 for return items outline the application in each case to the banks and/or customers and include:
     - Regulation CC Check 21 Substitute Check Indemnity
     - ECCHO Operating Rules:
       o Returning Member Indemnities for:
         • Breach of Returning Member Warranties
         • Responsibility for Check 21 Liability incurred by Returnee Member
       o Returnee Member Indemnity for Breach of Returnee Member Warranties
     - Regulation J
       o Paying Bank or Returning Bank Indemnities – For Sender’s Breach of Warranties Regarding the Item
       o Reserve Bank’s Certain Substitute Check Liability

5. Review Questions
   - The following questions are a review of key points covered in this section and may be used to further aid in the study of these topics. See “Section Four – Exhibits - Exhibit 10” for the Answer Key.
     - List the four presentment warranties outlined in UCC 4-208(a) that are made by the person presenting the item?
     - Under Federal law, the Remotely Created Check (RCC) warranty can be found in which regulation?
     - Where is the electronically-created item (ECI) and ECI Indemnity defined?
     - If an item that has been truncated is presented multiple times for payment, what warranty or warranties violation has occurred?

H. IMAGE EXCHANGE: PRIVATE SECTOR AND FEDERAL RESERVE

Learning Objective: The following section provides a review of key provisions of the predominant industry rules that govern check image exchange. A comparison is included that highlights the similarities and differences between private sector rules, with a focus on the ECCHO Operating Rules and Commentary, and the rules that govern exchanges through the Federal Reserve Banks – Operating Circular 3 (OC3) and Regulation J.

1. Image Exchange Rules – General Comparison
   - Image exchange via the Federal Reserve Bank (FRB)
     - FRB creates its own image exchange rules in Operating Circular 3 (OC3)
       o Does not incorporate the ECCHO rules into its Operating Circulars
     - Acts as a collecting bank and is a party to exchange of check images
     - Supports specific set of check image exchange products
   - ECCHO Member Exchanges
     - ECCHO creates and maintains rules for private sector image exchange
     - Rules apply only to exchanges among members or participants of a licensing organization
     - Forward collection process and returns process between ECCHO members covered by Rules if the members agree to the exchange
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- Participation is voluntary, by agreement of the parties
  - Members of ECCHO (not ECCHO), are parties to check image exchanges
  - ECCHO Rules are national rule set – neutral on vendors and products
    - Designed to accommodate all types of check image exchange models such as: Direct exchanges, Image archive and local/regional exchanges, etc.
    - Note: Remote deposit capture (RDC) agreements and other customer agreements support the bank-to-customer relationship
- See Figure 2.11 and Figure 2.12 below for illustrations of the forward presentment and return process respectively
  - Note where the ECCHO Rules apply versus the bank/customer agreements

Figure 2.11: Forward Presentment Image Exchange and ECCHO Rules

- Figure 2.11 above is a simple overview of a forward exchange process between ECCHO members
- Figure 2.12 below provides a similar view of a return process between ECCHO members
  - Note the terms used for members on the return side – referred to as Returning Member and Returnee Member depending on whether they send or receive the electronic returned check
2. **ECCHO Forward and Return Rules – Key Provisions**

   - Definitions specific to the ECCHO Rules (see Rules for a complete listing)

   - General Provisions:
     - Rules are clearinghouse rules under Uniform Commercial Code (Code) as contemplated by Section 4-103 of the Code and Reg CC Section 229.37
       - Rules supplement and vary provisions of Code and Reg CC
       - Rules shall bind each person interest in an item exchanged under the rules, whether or not they have specifically agreed to rules
     - Rules are an “agreement” under UCC and Reg CC

   - Compensation: Members may bring a claim for interest compensation under the Rules or applicable law

   - Eligible Items and Routing Numbers
     - Any check as defined as a check under Reg CC and drawn on an active regular routing number (RT) may be exchanged
     - Items eligible for imaging under the Rules - Image must be of an item that was a paper check (see Regulation CC definition) and may include:
       - Negotiable demand draft drawn on an office of a bank, a Federal Reserve Bank or a Federal Home Loan Bank; the Treasury of the United States;
       - Demand draft drawn on a state or local government that is not payable through or at a bank;
       - U.S. Postal Service money order;
       - Traveler's check drawn on or payable through or at a bank; and
       - Substitute check
     - Full MICR line is default
       - Assumes the potential need to create substitute check
     - Partial MICR line permitted by agreement
       - As-read MICR: MICR line information obtained from automated scanning or reading of check (paper or image) without repair, modification, or manual keying of MICR line information
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- Allowable characters for As-Read MICR Information:
  ✓ Numerics and special symbols allowable in MICR line information under applicable industry standards
  - RNA (Routing Number and Amount)
    - Include all information from routing number and dollar amount fields
    - Do not include other character (numeric or otherwise) not contained in MICR line of Related Physical Check
    - Only certain Rules apply to blank or replacement image (“Sorry” document)
  - Agreement for exchange (Banking Practices Agreement (BPA))
    - Agreement should specifically state there is “agreement to exchange under the rules”
    - Agreement can also include:
      - Operational logistics
      - Details of rules provisions that may be varied by agreement
    - BPA may be incorporated with other network agreements or clearing house rules
- Repair of Item
  - Prior to sending Electronic Check, Sending Bank may repair routing number and amount field information of:
    - A paper check prior to imaging,
    - An image, or
    - MICR line information in the Electronic Information
  - Sending Bank warrants correct repair
    - Routing Number and Amount (RNA) is the default
    - Full field repair permitted
  - Receiving bank indemnifies sending bank from consequential damages (if they make an error in making those repairs)
  - Sending Bank responsible for amount of item and expenses if they exercise ordinary care
    - Requirement to exercise “ordinary care” references UCC3-103
    - Same care Sending Bank would take handling their own bank’s items
    - Not a full “hold harmless” – No consequential damages
  - Other repair permitted based on law and agreement
- Third Party Agent
  - May use one or more Third Party Agents to perform functions provided for in the Rules
  - Bank remains responsible under Rules
- Electronic Check Formats
  - Industry Standards: Members use applicable industry standards and specifications for exchange of Electronic Checks and Electronic Returned Checks including applicable image file formats
    - Members may agree with each other to comply with additional standards and specifications
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- Compensation
  - Member may make a compensation claim in accordance with Rules
    - Must comply with the provisions set forth in Rules

- Data Security
  - Sending Bank warrants appropriate safeguards are established to protect data (administrative/technical/physical) during data prep and transmission
    - Does not include receipt and storage on Receiving Bank side
  - If there is a security breach
    - Notification to exchange partner required
    - Sending Bank is liable for cost of customer notification
      - Under ECCHO Rules this not limited to consumer data

- Adjustment Claims
  - Adjustment rules provisions in Section XII in Rules and Exhibit I - Adjustment Matrix
  - Must comply with requirements of Adjustment Matrix for:
    - Type of Adjustment, timing for claims, dollar amount, documentation or other requirements
  - Members may make Claim directly or through Provider
  - Adjustments may come from:
    - Forward or return under ECCHO Rules; or
    - From exchange outside ECCHO Rules but members agree to adjust under Rules
  - Members must determine to bring claim under rules or
  - Return, re-present or make claim through another channel
  - Except for Group Adjustment, a claim relates to only one image or return
    - Examples of: Group adjustment claim:
      - From same bundle/cash letter
      - Same transaction date
      - Same adjustment reason for all items (e.g.; Duplicate Items)
  - Adjustment matrix defines each adjustment type and outlines requirements for:
    - Time periods/Deadlines
    - Minimum $ Amounts
    - Acceptance Criteria
    - Required documentation
    - Other information needed to process, etc.
  - Notification
    - Must notify Sending Member of receipt of claim by end of next banking day after receipt; Notice in format / manner as agreed or established by provider
  - Documentation - May be sent various ways such as:
    - Electronic Check or Electronic Returned Check
      - Image, Substitute Check, Print-out, photocopy, other physical representation of item
  - Common adjustments: Following list of common adjustments covered in the ECCHO Rules and related Adjustments Matrix (see Exhibit I of the Rules)
    - Amount Error – Legal Amount (only applies to amount encoding errors)
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• Item was encoded for an amount different than the legal (written) amount; or written amount differs from the stated amount in X9.100-187 image cash/return letter
  • Timing: 180 calendar days with entry; up to 1 year without entry
  o Claim of Damage Due to Under-Encoding
    • Paying Bank requesting credit – For an under-encoded item charged to them and for which the paying bank is unable to collect the funds
    • Timing: 20 business days with entry; up to 1 year without entry
  o Duplicate Item
    • Institution received an item which it was asked to pay based on an item that it already had paid; regardless of form (e.g.; two images, and image and a substitute check, etc.)
    • Timing: 180 calendar days with entry; up to 1 year without entry
  o Entry in Error
    • Accounting entry was incorrectly made, either for the wrong amount or to the wrong party; includes adjusting errors and settlement
    • Timing: 20 business days with entry; up to 1 year without entry
  o Expedited Recredit (limited to substitute checks)
    • Check 21 expedited recredit claim (see Reg CC for details)
  o Late Return Claim
    • Depositary bank makes claim for an item it believes was returned late
    • Timing: 60 calendar days with entry
  o Mis-Mismatched MICR
    • MICR information associated with an item does not match MICR information reflected on image of that item
      ✓ Can be used when code line in the Check Detail Record (Type 25) does not exactly match code line on original check
      ✓ Can be used for any encoding errors other than an error in amount
    • Timing: 90 calendar days with entry; up to 1 year without entry
  o Non Conforming Image (NCI)
    • Item fails to meet image quality standards, image of item is missing, or item contains an invalid or undefined routing number (i.e. routing number not eligible for image exchange) or invalid data for specific file type or the item is ineligible for image clearing
    • Timing: 20 business days with entry; up to 1 year without entry
  o Non-Negotiable Item / Non-Cash Item
    • “Negotiability” defined in UCC (see UCC) and “Non-Cash Item” is defined in Reg CC
      ✓ Examples of non-cash items include items that enter collection stream in error such as empty carrier, control document, deposit/withdrawal ticket, pay stub or mutilated item, piggy back and item not encoded with magnetic ink
    • Timing: 90 calendar days with entry, up to 1 year without entry
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- Not Our Item
  - Forward collection process:
    ✓ Item that contains routing transit number (RTN) that does not belong to the institution that either receives item or is authorized to process the item
  - Return collection process:
    ✓ Item that was not indorsed or handled, either physically or electronically, by the institution that receives the return item
  - Timing: 20 business days with entry; up to 1 year without entry

- Return adjustment
  - Member institution seeks to adjust return item that was incorrectly returned
  - Timing: 60 calendar days with entry, up to 1 year without entry

- Rule 8 & Rule 9 Claims
  - Follow timing in ECCHO Rules (described later in this section)

- Source of Receipt Item
  - Request to identify from whom an institution received an item
    ✓ Information Adjustment Claim – Receiving Party must respond within 20 business days from date of request

- Unauthorized RCC Warranty Claim
  - Person on whose account RCC is drawn did not authorize the issuance of check in the amount or payee stated on the check
  - Timing: 90 calendar days; up to 1 year without entry

- Warranty Indemnity Claim – For Check 21 Warranty Claims or For Remote Deposit Capture (RDC) Indemnity Claims
  - Adjustment for claim of a Check 21 Breach of Warranty/Indemnity or for a claim for a breach of an RDC indemnity
  - Timing: 1 year

- Settlement & Settlement Timing
  - Members agree to process
  - If claim is through provider, settlement of provider may be used
  - Unless Members agree otherwise, settlement:
    ✓ “With entry” – By close of banking day following banking day claim was received
    ✓ “Without entry” – By agreement of members or a time period established by provider

- Compensation – Not covered under the Adjustment provisions
  - Can make a compensation claim under the ECCHO Rules Section VII – Compensation Rule
  - If adjustment provider allows, may make claim through the provider
  - Optionally may make claim outside the ECCHO Rules under applicable law or other rules

- Reject Claim – May reject or initiate claim to reverse settlement if claim:
  - Did not comply with Rules or Matrix
  - Did not relate to item handled by Member
  - Claim was duplicate of another claim
  - Member previously initiated claim relating to same matter
  - Member has not established factual basis for claim
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- Rules do not:
  o Establish liability for members with respect to claim
  o Alter Member’s obligation under UCC, Reg CC, or Rules
- Adjustment types updated from time to time based on member input and ECCHO Board of Director approval; for current list, see the ECCHO Rules - Exhibit I Adjustment Matrix, available at www.eccho.org or the excerpt in this guide: Exhibit 11
  o See also Exhibit 12 in this Guide for a side-by-side comparison of selected ECCHO and Federal Reserve adjustments
    • Compare and contrast adjustment/ITYP names, timing and other adjustment requirements

- Imperfect Image
  - Permits Sending Bank to send an Imperfect Image for forward exchange and presentment
  - Permits Returning Member to return an Imperfect Image item
  - Imperfect images are considered exceptions
    o Electronic Check / Electronic Returned Check containing image that:
      • Does not conform to industry standards
      • Does not pass quality edits for exchange
    o Must be identified / flagged
    o Some rules apply while others will not
    o Can be returned or adjusted
    o Can be used to create a substitute check
      • Creating bank fully responsible
    o Warrant receiving member and their customer will not incur loss as a result of receipt
  - Examples include:
    o Image of Item in Carrier
      • May qualify as Imperfect Image Item - if image of the carrier containing the item is unreadable or otherwise does not meet applicable industry standards
        ✓ Not all images in carriers considered imperfect – some are readable
    o Photo-in-Lieu (PILs)
      • PILs not required to have electronic flag
      • Printed legend on the photocopy meets this requirement

- Transmission of Images of Savings Bonds (for redemption by U.S. Treasury)
  - Rules allow transmission of savings bond from an agent to correspondent bank
  - Rules are agreement to transmit images of savings bonds between Members with exclusions
  - Savings bonds are not considered “items” or “checks” under UCC or Regulation CC
  - Receiving Bank must act with “ordinary care” as correspondent bank in receiving images of savings bonds.
  - Redemption, payment, creation and transmission of savings bonds subject to regulations and operating guidelines of the U.S. Treasury
  - Sending Bank warrants they comply with all requirements of the Rules
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- Comingling of images of savings bonds and checks allowed
  - Industry formats and specifications associated with image of the savings bond must meet Federal Reserve specifications
- Bank may reject and return image of bond for any reason prior to payment by Federal Reserve
  - Payment subject to correction and adjustment from Treasury or Fed
- Sending Bank responsible for full amount of rejected, returned image, correction or adjustment

• Electronic Check
  - Provision of Electronic Check of Eligible Item: Sending bank may transmit or make available image of an eligible item
  - Must indorse electronic check as required by Reg CC
    - If Depositary Bank (BOFD) must electronically indorse
      - Required under Rules to identify as such
      - Place Routing Number in the X9 file “Type 26” record
    - Electronic endorsement is legal equivalent of physical endorsement for purposes of Reg CC and UCC
    - Must include subsequent indorsements
      - Move forward the indorsements received (ensure complete chain of indorsements)
      - Aids in return processing and if needed to create substitute check
  - Status of electronic check – shall be deemed to be:
    - An “item” for purposes of UCC; and
    - An “Electronic Check” for purposes of Regulation CC
  - Transmission and Acknowledgement of Electronic Check
    - Image and associated Electronic Information for Electronic Check shall be transmitted or made available:
      - At location(s) designated or
      - Through the transmission facility of a Clearing House
    - Receiving Bank shall acknowledge receipt
  - Managing Electronic Connection
    - Sending Bank responsible for transmission
    - Receiving Bank responsible to manage its connection
  - Receipt: if Receiving Bank cannot process electronic file, it is not “received”
    - Must notify sender of failure to process within one business day
  - Examples of un-processable file may include:
    - File that is corrupted in some way, or
    - File that is not in the format required by the exchange network
  - Retention/Recreation: Within four business days Receiving Bank may request second transmission of same Electronic Check
    - Sending Bank respond by close of second Business Day
    - Sending Bank not deemed to breach duplicate warranty
    - Outside above timeframe Receiving Bank may request all or portion of Electronic Checks in first file
      - Sending Bank shall indicate whether it will comply with request
      - When acting in conformance with request Sending Bank not deemed to breach duplicate warranty
Presentment
- Electronic Check is presented to the Paying Bank when both the Electronic Information and the Image associated with the Electronic Check are received at or made available
- Image Ledger Cutoff time established by Paying Bank
  - Items received after this time are deemed to be received at opening of next business day
- Banks cannot agree to extend time of presentment
- Presentment starts processes related to returns timing:
  - UCC and Reg CC return clocks
  - Paying Bank requirement to settle for properly payable item
  - Paying Bank also has right to charge customer’s account (if bank chooses to do so) under their customer account agreement
- If Receiving Bank cannot identify specific Routing Numbers, it may refuse acceptance of, or return, the image that contains non-active Routing Number
  - May not reject entire file due to number of bad items

Retention
- Original Item - Sending Bank determines (based on each bank’s risk tolerance)
- At Paying Bank - Maintain copy for 7 years (or applicable law)
  - Can vary retention requirements by state

Warranties and Indemnities
- Sending Bank warrants that in addition to warranties in UCC and Reg CC:
  - Sending Bank warrants to Receiving Bank it has complied with all requirements of these Rules applicable to it
- Receiving Bank warrants that in addition to warranties in UCC and Reg CC:
  - Receiving Bank warrants to Sending Bank it has complied with all requirements of these Rules applicable to it
- Sending and Receiving Bank provide indemnification against damage, expense or loss, including attorneys’ fees, suffered as a result of the breach
  - Comparative negligence defense permitted to reduce recovery

Presumption of Alteration for Certain Items
- Presumption applies to adjustment claim, arbitration, dispute resolution, court proceeding or other legal action (“claim”) between Members with respect to image exchanged under rules
- Assumed for all purposes that check or image was altered unless Member can prove by preponderance of evidence the check is not altered but is counterfeit check as issued

Check 21 Provisions
- Recourse to prior bank for Check 21 liability
  - Allows liability incurred under Check 21 to be passed to prior bank
  - If check or image exchanged under Rules are then used to create substitute check, under Reg CC, that Truncating Bank (that created the image) incurs liability
- Expedited Recredit Claim for banks mirrors Check 21 provisions
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- Exchange of Images of Canadian Items
  - General provisions – Application of Rules
    - Governs exchange and return of Images of Canadian Items
  - Canadian Law applicable to Canadian items
  - Items eligible for exchange under Canadian Law
  - Destruction of Canadian Item within 120 days
  - Canadian image is "item" under UCC, but not a “Check” under Reg CC
    - FIs handle Canadian Image and Paper Return as collecting bank under the UCC
    - Provisions of UCC - Transfer warranties apply
  - Depositing customer agreement required
    - If RDC item, destroy original check within 120 days
    - Type of item customer will receive for return
    - Prohibition of redeposit without permission
    - Reg CC availability does not apply to foreign checks
    - Review current terms of account agreement and consider needed changes
  - Separate electronic files of different currency items
  - Industry formats and standards required
  - Gateway Receiving Bank may establish additional operational or formatting requirements
  - Image and Return of Canadian Item is legal equivalent of Canadian item
  - Rejection, return and correction or adjustment of Images of Canadian Items
    - Reg CC and UCC return timeframes do not apply
    - May return Image or Canadian Paper Return to FI that previously sent and maintain return reason codes
    - If Gateway Receiving Bank returns paper return, other Members maintain in paper form during return process
    - Only subsequent exchange of returned items if instructed or if eligible under Canadian Law
  - ECCHO Adjustment Rules will apply
    - Cannot create Substitute Check from Canadian item
  - ECCHO warranties apply to Canadian image and Canadian Paper Return Item, as appropriate
  - Sending Bank will indemnify Receiving Bank except if Sending Bank fails to exercise ordinary care or does not act in good faith
  - If Gateway Receiving Bank receives return warranty from Canadian FI it makes same warranty

- Figure 2.13 illustrates the forward exchange of images of Canadian items and the return process:
• Rule 8 and Rule 9: ECCHO Rules include special warranty claims processes and warranties related to the following:
  – Unauthorized Remotely Created Check – Claims Process (Rule 8)
    o Section XIX(N) of ECCHO Rules establishes a process for claim against Sending Member for a breach of the Reg CC presentment warranties with respect to a remotely created check
  – Forged or Counterfeit Check Warranty (Rule 9)
    o Section XIX(O) - ECCHO Rules establish a warranty that the signature of the drawer customer is not forged or unauthorized, and/or check is not counterfeit
    o Rules outline a specific claims process and related timings
  – Figure 2.14 provides a brief comparison of key features of Rules 8 & 9:

<table>
<thead>
<tr>
<th>Rule 8 and Rule 9 Overview</th>
<th>Rule 8</th>
<th>Rule 9</th>
</tr>
</thead>
<tbody>
<tr>
<td>Remotely created check – Unsigned draft</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Forged or Counterfeit check – Fraudulent signature item</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Source of Warranty: Regulation CC [Section 229.34(d)]</td>
<td>✓</td>
<td></td>
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<tr>
<td>Source of Warranty: ECCHO Rules [Section XIX(O)]</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Opt-out Option?</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Exchanges in Which Warranties Arise?</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>• Federal Reserve Bank exchange,</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>• Private sector exchange (ECCHO Rules)</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>• Correspondent exchanges (non-ECCHO)</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Unauthorized Claim May Be Handled Via Federal Reserve Bank Adjustment?</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Unauthorized Claim May Be Handled Via Private Sector Adjustment?</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Breach of Warranty Claims May Be Handled Between ECCHO members?</td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>
SECTION TWO – TRAINING GUIDE

- Remotely Created Check Warranty Claim Process
  - Generally referred to as “Rule 8”
    o Developed in local paper clearing houses
    o “Rule 8” is how it is commonly known
      • Section XIX.N in the ECCHO Rules
  - Definition of RCC and warranty provided under Reg CC (July 2006 amendment)
    o Warranty moves liability from Paying Bank to BOFD for an unauthorized remotely created check
  - Warranty and definition previously in ECCHO Rules
    o Removed when added to Regulation CC
  - ECCHO Rules now set forth claim process for Paying Bank to make an Unauthorized RCC (Rule 8) warranty claim
    o Detailed process and related timing outlined in the Rules for handling/responding to breach of warranty claim
      • See Section XIX(N) and related Exhibits in the ECCHO Rules for details
  - Illustration in Figure 2.15 shows the timing and parties in the claims process for a “Rule 8” claim

Figure 2.15 ECCHO Rules Warranty Claims Process For “Rule 8”

- ECCHO Rule states:
  o Paying Bank’s customer must complete/sign/deliver a written statement under penalty of perjury (WSUPP); and
SECTION TWO – TRAINING GUIDE

- Paying Bank must deliver claim to BOFD within 90 calendar days after presentation of item in question
- Claim must be made to location BOFD receives returns
- Aligns to Fed process and the ECCHO adjustment process for Unauthorized Remotely Created Check (URCC)
- BOFD may not disclaim on basis of evidence they (or their customer) have that the item was authorized by the Paying Bank’s customer

• Unauthorized RCC – Warranty claim in Adjustment Matrix
  - Allows Rule 8 claim through adjustments
  - Mirrors the Fed process and timing
  - BOFD may not disclaim the RCC adjustment claim by stating Paying Bank’s customer authorized RCC
  - If Paying Bank determines it has breach of warranty claim, has three options:
    - Make claim to BOFD via return channel
      • Rule 8 claim – Section XIX(N) of the Rules
    - Use adjustment process for RCC warranty claim
      • Section XII of the Rules
    - May make claim outside ECCHO rules process

• Forged and Counterfeit Check Warranties
  - Generally referred to as “Rule 9”
    - Started in local paper clearinghouses
    - “Rule 9” is how it is commonly known
      • Section XIX.O in the ECCHO Rules
    - Unique to ECCHO Rules and private sector exchanges
  - Sending Bank (that is Depositary Bank) warrants:
    - Signature of purported drawer is not forged or otherwise unauthorized, and/or
    - Related Physical Check is not counterfeit
  - Participation is default in Rules
    - Opt-out permitted unless clearing arrangement does not allow
    - If opt-out is cancelled (default back to participation under the rules), cannot elect to opt-out again for 6 months
  - ECCHO Rules set forth claim process for Paying Bank to make a Forged/Counterfeit (Rule 9) warranty claim
  - Similar process as RCC (Rule 8) warranty claim
    - Claim made through return process but is not a return
    - No adjustment facility for these claims in ECCHO Rules
  - Cannot send these claims through the Fed
  - Rule 9 can be disclaimed for the following reasons:
    - Account closed
    - Claim amount exceeds funds in account
      • Depositary Bank only required to check account balance once
    - Claim not made timely
    - Depositary Bank is not first bank to which check was transferred (BOFD)
    - Depositary Bank had in place, at the time of this Electronic Image exchange, an effective election to have its Electronic Image exchanges not subject to this rule
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- Opted out of participation
  - Illustration in Figure 2.16 shows the timing and parties in the claims process for a “Rule 9” claim

Figure 2.16 ECCHO Rules Warranty Claims Process For “Rule 9”

- Current ECCHO Rule states:
  - Paying Bank’s customer must complete/sign/deliver a written statement under penalty of perjury (WSUPP) within 60 calendar days from the date their statement is available;
  - Paying Bank then has 15 business days within which to file the claim
  - BOFD may request copy of WSUPP from Paying Bank within 15 business day of receipt of claim
    - If copy of WSUPP requested, Paying Bank has 15 business days to provide copy
  - BOFD must then honor claim unless there is reason to disclaim
    - May disclaim on basis of:
      ✓ Account closed; or
      ✓ Insufficient funds in depositing customer’s account to cover amount of the claim; or
      ✓ If claim process was not timely

- Electronic Returned Check Provisions
  - Electronic Return provisions that are same from Forward Exchange
    - General Provisions
    - Compensation
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- Data Security
- Third Party Agent
- Retention/Recreation
- Exchange Arrangements
- Managing Electronic Connection
- Agreement for return
- Allow members to correct received MICR line due to error or omission
- Indication on Return that item:
  - Is a return, and the reason for return
- Return reason and Returning Members indorsement
  - Must be included in Electronic Information associated with Electronic Returned Check
- Member may rely on return reason and indorsement in electronic record
  - Without review of any return reason and/or indorsement contained on or within image of Electronic Returned Check
- Retention of indorsements is recommended
- Multiple Reasons – Not required to indicate all applicable reasons for return
  - For example - if you know item is bad quality but could also be NSF, not required to indicate all reasons for return
- Return Routing
  - Must follow Return Routing Hierarchy as illustrated in Figure 2.17 below to determine where to route a return

Figure 2.17 ECCHO Return Routing Hierarchy

- Transmission and Timeliness of Return
  - Location designated by Returnee Member
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- Timeliness as required under applicable law (UCC and Reg CC)
  - If the Returnee Member that is BOFD has physical check, must
    - Indicate it is a return and the reason for the return; and
    - Return the item as required under applicable law
  - If the Returnee Member that is the BOFD for Related Physical Check or an Electronic Check of Related Physical Check that corresponds to Electronic Returned Check:
    - May not reject return unless Electronic Returned Check incorrectly identifies the Returnee Member as the BOFD

- Warranties and Indemnities - Returns
  - Returning Member warrants that in addition to warranties in UCC and Reg CC:
    - Returning Member warrants to each Returnee Member that it has complied with all requirements of these Rules applicable to it
  - Returnee Member warrants that in addition to warranties in UCC and Reg CC:
    - Returnee Member warrants to the Returning Member that it has complied with all requirements of these Rules applicable to it

- Sending and Receiving Bank provide indemnification against damage, expense or loss, including attorneys’ fees, suffered as a result of the breach
  - Comparative negligence defense permitted to reduce recovery

- Re-presentsments
  - Two permitted under ECCHO rules (three total presentments)
    - Same as number of re-presentsments permitted under NACHA Rules for ACH entries
  - Contrast to one permitted through the FED (two total presentments)

- For complete review of the ECCHO Rules, see the ECCHO Operating Rules and Commentary available at: www.eccho.org/
  - Review ECCHO FAQs at www.eccho.org/faq
    - Frequently Asked Questions Regarding ECCHO Rules Compliance

3. Federal Reserve Rules – Operating Circular 3 (OC3) and Reg J

- NOTE: The provisions outlined here for Operating Circular 3 (OC3) are based on 2018 effective version. Updates to OC 3 and corresponding warranties reference in Regulation J, were not available when this Guide was updated. Only the 2018 effective versions for both Regulation J and OC 3 are covered here, in NCP training and on any related question on the 2019 NCP Exam.

- General Provisions
  - Monitoring Account – Forward and Return
    - Depositary, Collecting or Paying Bank responsible to monitor Fed account to ensure receipt of forward presentment items and returns
  - Cutoff Hour Return Deadline
    - For purposes of return, a forward item received after 2:00 p.m. local time is considered received next banking day
Definitions of terms set forth or incorporated in Regulation J, including terms defined in Regulation CC, apply in this Circular, except as otherwise provided in this Circular:

- **Item**: Includes a cash item and a returned check
- **Cash item**: Does not include a returned check
- **Returned check**: Cash item and a check as defined in Regulation CC, that is returned by a paying bank

**Check**: Draft, as defined in the Uniform Commercial Code, that is drawn on a bank and payable on demand

- **Item**: An instrument or a promise or order to pay money, whether negotiable or not, that is payable in a Federal Reserve District and collectible in funds acceptable to the Fed
- **Electronic item**: Must include an electronic image of check and information describing that check
  - Must conform to Federal Reserve technical requirements for processing electronic items
  - Must be captured from a check

**Items Fed Handles as Cash Items**

- Checks (other than one classified as noncash item) including:
  - Government check, postal money orders, and food coupons;
  - Postdated check, payable in a state;
  - Other demand items, acceptable to paying bank’s Administrative Reserve Bank;
  - Demand items payable outside of a state acceptable to the last collecting Reserve Bank;
  - Electronic items that conform to the requirements of this Circular and the technical requirements of the Reserve Bank as amended from time to time;
  - Substitute checks

- Sender may send Fed certain redeemed savings bonds and saving notes
  - Fed treats savings bonds and notes as cash items only to the extent provided in Appendix C of OC 3
  - Handles redeemed Savings Bonds as fiscal agents of the US Treasury
  - Sender may send in paper form or as electronic image of a Savings Bond
    - Imaged savings bonds may be submitted in separately sorted image cash or in mixed image cash letters, containing imaged savings bonds and images of other types of cash items
    - Must meets the specifications set forth in the Savings Bond Processing Quick Reference Guide
  - Fed makes no warranties with respect to the Savings Bonds
  - Will give immediate credit, subject to payment and adjustment
    - Fed will make corrections and adjustments as necessary on behalf of, and as directed by the Treasury

- Any other item payable on demand and collectible at Reserve Bank that receives the item and is willing to accept as a cash item

**Items Fed Does Not Handle as Cash Items**

- Bank on which the item is drawn has declined to pay the item two or more times (only two presentments permitted)
- Has retired routing number (as defined by ABA’s Registrar of Routing Numbers)
Includes passbook, certificate or other attached document;
- Has special instructions including request for special advice of payment or dishonor;
- Does not qualify for handling by high-speed check processing equipment;
- Has not been preprinted or post-encoded in magnetic ink with the routing number of the paying bank (or nonbank payor), and the dollar amount
- Does not include paying bank routing number in fractional form in upper right corner
- Item in the amount of $100,000,000 or more
  - Reserve the right to return items in amounts less than $100,000,000 that are judged to be intended to avoid the $100,000,000 limit
- Any item that Fed judges should not be handled as cash item

- Warranties and Indemnity
  - Sender warrants and indemnifies Reserve Bank
    - Against any loss, claim, or damage that results in the handling of these items
    - See warranties and indemnification section in next section of this presentation for detailed comparison of warranties

- Electronic Access
  - Use of electronic connection
    - Bank agrees to terms established in OC5
    - Not every electronic access supports every feature; May need more than one electronic access
  - Bank is a “Participating Bank” and must:
    - Establish bank's systems functionally compatible with Reserve Bank
      • Capable to process volumes
    - Meeting conditions require
      • Identify Reserve Bank office where items will be sent
      • Specify maximum volume
    - Bank must execute agreement with Fed and meet conditions of Fed
      • Bank has continuing obligation that systems are compatible
    - Need prior consent to exceed daily maximum

- Electronic Services
  - Disruptions in Electronic Services
    - Problems may disrupt electronic access to services
    - If unable to provide service Fed/Bank to notify Bank/Fed
      • May elect to use physical form
    - Bank must be prepared to meet its legal obligations when electronic access not available
    - Information is deemed to be sent/received at physical location identified by the RT
      • Time is deemed local time of location
    - Fed and Bank may exchange items in paper form
  - Agent – Bank may select agent to act on their behalf to:
    - Access Fed system to process checks
    - Send/receive cash letters and return cash letters
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- Bank warrants that information is substantially accurate
- Bank is responsible for security and controls
  - Must settle based on exchanges of agent

Transmission
- Delivery and receipt
  - All information (forward/return) is delivered by Fed/Bank and received by Bank/Fed when placed in file on Fed storage device that makes file available to retrieve or review
    - Fed may also transmit to Bank
- Bank must manage its electronic connection
  - If fail to manage, Fed may limit attempts to send
  - Fed deemed to have sent information
  - Fed records determinative as to delivery / receipt
- By use of electronic connection, Bank agrees that connection is reasonable means of communication

Retention
- Bank bears responsibility to retrieve its files in timely manner
- Fed not obligated to retain or make copies of electronic items
  - Fed retains cash letter no longer than two days

Cash Letter Processes
- Cash Letter Prep
  - Items may be listed by amount without further description
  - Cash letters dated and identified by sender’s name /routing number
  - Accept following items forward/return only in special cash letters
    - Noncash items
    - Carrier documents
    - Food coupons
    - Foreign items
    - Photo-in-Lieu (PIL)
  - May require cash items (for forward presentment) to be separately sorted from returned checks
- Image and Return Cash Letters
  - Sender provides file conforming to standards
    - Conform to DSTU X9.37 and FRB user document
    - Operating Circular 3 refers to DSTU X9.37 as amended
      - Amended standard generally same as X9.100-187 standard
  - Files must be transmitted by means of electronic connection
  - Entire file must be received prior to processing deadline
    - Must successfully pass Reserve Bank edits
  - Not responsible for delays in handling or lost files
  - Reserve Bank will send acknowledgment to sender
    - Receipt acknowledgement (positive) or
    - Non-receipt(negative)
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• Indorsements
  – All cash items and return checks sent must be indorsed according to Reg CC
    o Items received without sender’s indorsement, FRB may:
      • Present as if indorsed
      • Add the indorsement
      • Return item

• Availability of Credit
  – Federal Reserve accepts items, forward and return in accordance with published
    schedules and procedures
    o Provides credit in accordance with published circulars

• Presentment
  – Federal Reserve Bank may physically present items at any location as defined
    in Reg CC
    o Paying bank is considered to receive a cash item when delivered as
      requested or when made available for pickup as arranged
  – Reserve Bank may present an electronic item to Paying bank by transmitting or
    delivering an image cash letter containing the electronic item
  – Presentment occurs when the image cash letter is:
    o Transmitted to the paying bank, or
    o Written on the Reserve Bank’s data storage device
      • Must be in a form that is available for retrieval by the paying bank

• For Forward Presentment and Return:
  – Federal Reserve Bank has no responsibility for giving notice to a sender of
    anticipated delays in presentment or return of cash items unless:
    o Delay is expected to involve at least ten paying banks and
    o Lasts at least three business days

• Returned Checks
  – Paying bank may return through Fed if it meets deadlines
    o May send to Fed items not handled in forward exchange
    o No commingling of forward and return items within cash letters
  – Bank sending returned check warrants return is within legal timeframes and
    indemnifies Fed from any loss
  – Fed does not agree to handle item more expeditiously than is required under
    Reg CC
  – If Bank unable to identify depositary bank on check received from Fed, Bank
    may send back to Fed
  – Fed may rely on amount and depositary bank in appropriate field
  – May send returned check to depositary bank sorted separately from forward
    cash letter
  – May return item to depositary bank or prior collecting bank by returning
    electronic image and data
    o Return occurs when image return is written on data storage device

• Return Checks
  – Fed may resend file two days after original file sent
Based upon request
- Bank indemnifies Fed for any loss
- Return conforms to Fed’s technical or operational requirements
- Bank must settle for returns as it does cash items
- If return mis-sent, encourage to send promptly to identified depositary bank
  - If unidentified, bank send NOI to Fed
  - Further NOI discussion in Adjustments session
- Fed does not handle as a cash item an item that has been declined for payment two or more times
  - Only allows two total presentments

Appendices
- OC3 also includes various appendices for specialized products and services offered by Federal Reserve Bank
  - Appendix A: Government Checks
    - FRB handles checks drawn on the US Treasury as cash items
  - Appendix B: Postal Money Orders
    - FRB handles postal money orders as cash items under an agreement between US Postal Service and the Reserve Banks
  - Appendix C: Redeemed Savings Bonds and Savings Notes
    - FRB handles redeemed Series A, B, C, D, E, EE, and I Savings Bonds and Savings Notes as fiscal agent of United States
  - Appendix D: Foreign Cash Items
    - FRB from time to time designates specific Federal Reserve Bank check processing offices to handle items payable in Canada, including Canadian postal money orders payable in U.S. funds and other specified kinds of items payable outside of a State (collectively, "foreign items"), as cash items
  - Appendix E: MICR Presentment Services
    - Sets forth terms under which FRB provides certain MICR presentment services to a paying bank, generally the presentment of a check via electronic transmission of data obtained from its MICR-line
      - Includes several types of services
  - Appendix F: Other Check Services
  - Appendix G: “Check 21” Services
    - For cash letters in paper form, specially identified for accelerated processing, FRB will provide credit and will accelerate processing by converting the items into electronic items and thereafter presenting them to paying banks either as electronic items or as substitute checks
  - Appendix H: Electronic Check Adjustment and Documents to Follow Archive
    - FRB permits banks to submit, receive and respond to electronic adjustment requests and to submit, receive and access supporting electronic documentation
      - Terms and procedures specified in OC 3 and the Check Adjustments Quick Reference Guides govern the handling of electronic adjustment requests
  - Appendix I: Fedimage Information Services
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- The capture or importation of electronic images of checks, storage or archiving of the images, and delivery of check image files to an Institution by the FRB

- Other Provisions
  - Notice of Non-Payment Service
    o Paying Bank may request service, may be products such as:
      • Fedline for the Web or Fedline Advantage
      • Similar to EARNS (Electronic Advance Return Notification System)

- Charges
  - Fee schedules outline the charges imposed by the Fed for handling cash items, returned checks, notices of nonpayment, processing exceptions, and related services
    o Reserve Bank may charge to account maintained or used by the bank requesting the service or based on other agreements

- Adjustments
  - Federal Reserve does not perform adjustments for every kind of claim, only those specifically covered in OC 3 and the online Check Adjustments Quick Reference Guide
    o Bank may need to pursue other claims directly with another bank
  - Forward/return item to be adjusted must have been exchanged through the Fed
  - Check Adjustments Quick Reference Guide
    o Specifies adjustments Reserve Banks handle and related requirements and timeframes for submitting different adjustment requests
      • Information required will vary depending on investigation type (ITYP)
  - Minimum dollar threshold to adjust through the Federal Reserve is $0.01
    o Two exceptions: Late Return Claim (LC) and Late Return Disclaimer (LR) which are $100 minimum
  - Figure 2.18 shows the top incoming adjustment types through the Federal Reserve Bank which made up approximately 97% of all claims reported through the FRB in the first seven months of 2018 with the following breakdown:
    o ENC (encoding error claims) = 42%
    o PAID (duplicate item claims) = 34%
    o NCH (noncash item claims) = 14%
    o ERR (entry made in error claims) = 2%
    o LC (item returned late claims) = 2%
    o All other claims = 3%
Selected investigation types (ITYPs) follow (listed alphabetically):

- **DUP** – Duplicate Entry
  - Request to reverse/investigate a previous adjustment entry that appears to be a duplicate.
  - Does not apply to PAID items or duplicate items charged in a cash/return letter; see PAID ITYP description below

- **ENC** – Encoding Error
  - Item clearly encoded for an amount different than the legal (written) amount; or written amount differs from the stated amount in the image cash/return letter

- **ERR** – Entry in Error
  - Request to reverse/investigate an entry made in error

- **LC** – Late Return Claim
  - Depositary institution claims item was returned late
    - Must be $100 or greater (same for both ECCHO and Fed adjustment rules)

- **NCH** – Non-Cash Item
  - To request entry for a non-valid item or other item included in a cash/return letter received from FRB or an item that does not meet legal equivalence requirements for Check 21
    - Examples: Control document, MICR mismatched item, etc.

- **NOI** – Not Our Item
  - Item was charged in a cash/return letter which does not bear the receiving institution’s routing number in the MICR line for forward collection or in the endorsement area for a return of the physical item or image or in the associated endorsement records for items received electronically
    - Does not include or apply to “mismatched items” which would be adjusted using NCH
    - Not as common in image cash letters
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- **PAID – Paid Item**
  - Request for credit for item that is being refused either because it is the original (or the legal equivalent, i.e. a substitute check or image) or a photocopy and the other item has already paid

- **WIC/Warranty/Indemnity Claim Associated with Check 21 Items**
  - Depository institution alleges breach of a Check 21 warranty or indemnity

- **WIC/Warranty/Indemnity Claim Associated with Unauthorized Remotely Created Checks (URCCs)**
  - Paying institution alleges a remotely created check was not authorized in the amount stated on the check to the payee indicated on the check.

- **WIC/Warranty/Indemnity Claim Associated with Remote Deposit Capture (RDC) Items**
  - Paper Deposit Bank alleges they received an original paper check that was returned unpaid (PAID adjustment entry or a Return Letter) due to check being previously deposited using RDC service
  - RDC item must have been processed through FRB, RDC Bank must have received settlement for the item with no return of the item

- **WIC/Warranty/Indemnity Claim Associated with Unauthorized Electronically Created Item (UECI)**
  - Paying institution alleges ECI was not authorized by the person on whose account the electronic item was created in the amount stated on the item or to the payee stated on the item (only one of these conditions must be met)
  - ✓ Note: Electronically-created item (ECI) defined in Regulation CC

- **Other adjustment considerations – common errors occur with usage of the PAID versus DUP adjustment ITYPs**
  - Differences between the DUP and the PAID adjustments are the usage and reporting time frames
  - DUP is used when requesting reversal or investigation of an accounting entry that appears to have been previously made
  - Should not be used to report items that paid twice
    - ✓ Timing: Adjustment request must be received within 20 business days of most recent entry date
  - PAID is used when requesting credit for an item that is being refused either because it is the original check, substitute check or image received in an image cash/return letter and the other item is already paid
    - ✓ Timing: Adjustment request must be received within six (6) calendar months of the cash/return letter date of the item being reported as paid


4. Image Exchange Rules – Key Differences
   With image exchange, checks may be flowing through multiple exchange channels that operate under different rules and agreements
Comparison of Federal Reserve’s rules for image exchange (Operating Circular 3) and the ECCHO Operating Rules is shown in Figure 2.19

Generally, there are many similarities between these industry rule sets:
- Rely on Regulation CC for:
  - Definitions and warranties for the exchange of electronic checks and electronic returned checks
  - Similar defenses for comparative negligence
  - Backup indemnity for Check 21

<table>
<thead>
<tr>
<th>Federal Reserve Rules</th>
<th>ECCHO Rules</th>
</tr>
</thead>
<tbody>
<tr>
<td>Presentment is based on what is “sent”</td>
<td>Presentment is based on what is “received”</td>
</tr>
<tr>
<td>- Presentment occurs when the electronic data is sent or made available to the Paying Bank; Considered “presented” when placed on FRB storage device for Paying Bank</td>
<td>- Presentment occurs when the electronic check and the electronic information are received or made available to the Paying Bank</td>
</tr>
<tr>
<td>Indemnities from Sending Bank</td>
<td>Indemnities from Sending Bank</td>
</tr>
<tr>
<td>- When FRB sends items to Paying Bank, no indemnity is provided other than Check 21-related indemnity</td>
<td>- ECCHO rules provide full indemnity for breach of image rules warranties</td>
</tr>
<tr>
<td>Remotely Created Checks (RCC) Claims</td>
<td>Remotely Created Checks (RCC) Claims</td>
</tr>
<tr>
<td>- Handled only through adjustment process</td>
<td>- Handled as either return (Rule 8 claim) or adjustment process</td>
</tr>
<tr>
<td>- Only for items sent forward through the Fed</td>
<td>- Can be items sent through Fed or ECCHO forward exchange</td>
</tr>
<tr>
<td>Fed requires Full MICR line for item to be eligible to exchange</td>
<td>ECCHO Rules default is FULL MICR</td>
</tr>
<tr>
<td>- Required to create substitute check</td>
<td>- Allow Partial MICR by agreement</td>
</tr>
<tr>
<td>Adjustments</td>
<td>Adjustments</td>
</tr>
<tr>
<td>- Item to be adjusted must have been exchanged through FRB</td>
<td>- Rules allow items to be adjusted between members that may/may not have been exchanged under Rules</td>
</tr>
</tbody>
</table>
5. **Warranties/Indemnification Review**
   Understanding and comparing the warranties and indemnification regarding certain exchanged items:
   - Electronic check and electronic returned check, the imperfect image items permitted under the ECCHO Rule, Rule 8 and Rule 9 and more.
   - See “G. Warranties and Indemnification” and Exhibit 5 through Exhibit 7 for details on the warranties and related indemnifications in the ECCHO Rules, Uniform Commercial Code (UCC), Regulation CC, and Regulation J, as referenced by Fed OC3.

6. **Suggestions for Further Study**
   - ECCHO Rules Summary and ECCHO Operating Rules and Commentary
     [https://www.eccho.org](https://www.eccho.org)
   - Federal Reserve Banks Operating Circular No. 3; Collection of Cash Items and Returned Checks
     [http://www.frbservices.org/regulations/operating_circul](http://www.frbservices.org/regulations/operating_circulars.html)
   - Federal Reserve “Check Adjustments Quick Reference Guide”

7. **Review Questions**
   - The following questions are a review of key points covered in this section and may be used to further aid in the study of these topics. See “Section Four – Exhibits" - Exhibit 10 for the Answer Key.
     - If an item is not fully qualified, how may it be eligible for exchange under the ECCHO Rules?
     - Under common image exchange rules, when does presentment occur?
     - Under what circumstances would a Claim of Damage Due to Under-Encoding adjustments claim be filed?
     - Under the ECCHO Rules, what option(s) are available to make an Unauthorized RCC claim?
     - The Forged and Counterfeit Check Warranty (commonly known as “Rule 9”) allows an ECCHO member to send such claims directly to another ECCHO member or through the Federal Reserve. True or False?
     - Under the Federal Reserve Bank Operating Circular 3 (OC3), the Fed may reserve the right not to handle an item if, in its discretion, it judges that it should not be handled as a cash item. True or False?
     - Cash items and return checks sent to the Federal Reserve Bank must be indorsed according to the requirements in Reg CC. If items are received without indorsement, what does OC3 state are options available to the Federal Reserve Bank to handle such items?
     - Under the Fed adjustment rules describe when a PAID adjustment claim is used versus when a DUP adjustment claim may be filed?
     - Under the ECCHO Rules, if the Sending Bank is also the depositary bank, how must it identify itself?
I. FRAUD AND RISK

Learning Objective: The following section reviews various types of payments fraud. Examples are provided with possible methods to prevent and/or detect check payments fraud. Regulations, guidance and compliance considerations established under the Bank Secrecy Act/Anti-Money Laundering (BSA/AML) and the Federal Financial Institutions Examination Council (FFIEC) are also outlined. For a complete list of the program and exam reference materials, please see resources linked here: https://www.eccho.org/ncp_training

1. Fraud: Defined as the intentional misrepresentation of material existing fact made by one person to another with knowledge of its falsity and for the purpose of inducing the other person to act, and upon which the other person relies with resulting injury or damage

   - May be made by omission or purposeful failure to state material facts, which nondisclosure makes other statements misleading
   - Misrepresentation/omission must relate to an 'existing fact' [Source: www.uslegal.com]
   - Fraud exists in all payments systems and occurs when following elements exist:
     - Intentional untrue representation about an important fact or event
     - Untrue representation is believed by the victim
     - Victim relies upon and acts upon the untrue representation
     - Victim suffers a loss of money and/or property as a result of reliance on untrue representations

   - Check Fraud: Refers to a category of criminal acts that involve making the unlawful use of checks to illegally acquire or borrow funds that do not exist within the account balance or account-holder's legal ownership [Source: www.uslegal.com]
     - For additional information, please see recent industry studies:
       - Federal Reserve’s triennial Payments Study (2016)
       - ABA Deposit Account Fraud Survey (2016)

2. Types of Fraud – Fraud schemes involving checks take various forms including:

   - Altered check
     - Amount and /or Payee changed to benefit the perpetrator
     - Timing to discover and make claim:
       - UCC claim on altered check has three years; based on statute of limitations
       - Counterfeit check must be discovered by the midnight deadline
       - Based on the UCC transfer and presentment warranties and related timings:
         • Paying bank liability is generally minimized if check is altered;
         • BOFD liability is generally minimized if check is counterfeit
     - Altered information can be entered using various methods of printing, typing or may simply be handwritten
     - Altered characteristics can include:
       - Ink that smears when rubbed
       - Dollar amounts – Numeric vs. Written different
       - Different color pen ink
       - Inconsistent spacing where the numeric portion has been altered
       - Inconsistent type from different printers or typewriters used
       - MICR line altered to delay clearing/return
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- Counterfeit check
  - Created by an entity not authorized by the account holder and issued without the account holder’s authorization
  - Presented based on fraudulent identification
    - Due to identify theft or other stolen information
  - May be false checks drawn on valid accounts (such as multiple copies of a valid check)
  - Counterfeit Characteristics
    - Poor quality paper stock
    - Absence of one serrated edge or check printer’s name or trademark
    - Misspelled printed information
    - Check number ranges inconsistent or out of range
    - MICR line missing, crooked, shiny or not machine readable
    - Check number located in the wrong position of the MICR line
  - Counterfeit check return must be within UCC midnight deadline

- Corporate Account Takeover
  - Technologically advanced form of electronic crime typically involving exploitation of businesses of all sizes, especially those with limited computer safeguards or disbursement controls for online business banking
    - Cyber thieves may gain access to company’s computer system to steal confidential banking information to then impersonate the business and send unauthorized wire and ACH transactions to unauthorized accounts
    - Malicious software that may be available over the Internet can automate many elements of this type of fraud including circumventing one-time passwords, authentication tokens, and other forms of multi-factor authentication

- Deposit Account Fraud
  - Check Kiting: Opening accounts at two or more institutions and using “the float time” of available funds to create fraudulent balances
    - Customer creates a continuous interchange of worthless checks
    - Involves covering overdrafts with deposits of checks creating overdrafts at another bank
      - Image exchange faster clearing and related controls can reduce this
    - Detecting Check Kiting
      - Deposit / Balance Review
      - Monitor daily float reporting and use of uncollected funds
      - Look for frequent overdrafts
      - Depositing checks drawn on the customer’s other bank accounts
      - Deposits and checks clearing in similar amounts
      - Deposits of large checks drawn on out-of-area banks or foreign banks
      - Customer Account Review
        - Several accounts with similar names, owners or signers controlled by same individual
        - Low average daily balance in relation to deposit activity
        - Low collected-funds balance in relation to the book balance
        - Volume & dollar amount of activity in relation to nature of the business of account holder
- Closed Account Fraud: Closed account frauds are based on checks being written against closed accounts
  o Invalid routing number
  o Retired routing number
  o Nationally shared databases help reduce fraud if utilized
  o Generally, relies on the float time involved in interbank transactions
- Paper-Hanging
  o Customers purposely writing checks on closed accounts (their own or others), as well as reordering checks on closed accounts
  o Relies upon float time
- New Account Fraud: Check fraud and identity theft through this method
  o New account representative is the key
  o Proper training/procedures required
  o Criminals may learn information about a financial institution customer and use personal information to misrepresent themselves as the valid account holder. Schemes may involve:
    • Changing account information
    • Creating fictitious transactions between unsuspecting parties
    • Preparing checks drawn on the valid account that are presented using the false identification
- **DDoS: Distributed Denial of Service:**
  - Type of fraud tied to an attack on a public website
  - Designed to slow website response times, intermittently prevent customers from accessing institutions’ public websites and/or online services, and adversely affect back-office operations
  - May also serve as a diversion by criminals attempting to commit fraud via stolen customer or employee credentials to initiate fraudulent wire or ACH transfers
  - Financial institutions may face a variety of risks, including operational risks and reputation risks and if DDoS attack is coupled with attempted fraud
  - Financial institutions may also experience fraud losses as well as liquidity and capital risks with this type of fraud
- Forged Checks
  - Use of legitimate blank checks with a false imitation of the payor signature
  - May be perpetrated by person known to payor
    o Check orders stolen from mailbox
  - Increases following natural disasters
- Forged Endorsements
  - Often uses a stolen check, which is then endorsed and cashed or deposited by someone other than the payee
  - Payable to multiple parties
  - Endorsement on back of check
    o One party endorses the check for all parties
  - Warranty for adjustment up to three years based on UCC
- Telemarketing
  - Based on the creation of “demand drafts”
  - Demand draft resembles a personal check, but carries no signature
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- In place of a signature, it states the account holder has given permission to have money withdrawn from his or her checking account to pay bills for goods and services

- Remotely Created Checks (RCCs)
  - Some perception all RCC’s are fraudulent
  - RCCs are unsigned drafts
  - Defined in Reg CC
    - Warranty including in Reg CC - transfer and presentment warrant that shifts liability for an unauthorized remotely created check to the institution where it is first deposited:
    - Any bank that transfers or presents a remotely created check warrants the check is authorized by the person on whose account the check is drawn

3. Fraud Preventive Measures

- Financial Institution - General methods to deter all types of payments fraud include:
  - Know Your Customer
    - Strengthen relationships with customers (face-to-face time)
  - Teller training
    - Both regulatory and bank policy and procedures
  - Full extent prosecution
  - Review customer ID thoroughly
    - Require endorsement in front of teller with valid ID
    - Look for fluidity in writing
  - Maintain separation of functions
  - Maintain permanent signature cards & appropriate business documentation
  - Reg CC extended holds
    - Permitted for items believed to be uncollectible or new accounts
    - Place special holds on checks drawn on dormant/inactive accounts
  - Advise customer destroy checks for unused or closed accounts
  - Properly close accounts
  - Be engaged with financial services industry conferences and work groups

- Paper Security Features
  - Paper Security Options
  - Watermarks
  - Copy Void
  - Chemical Void
  - High Resolution Micro-printing
  - Three Dimensional
  - Security Links
  - Optical Variable Ink (OVI)
  - Thermo-chromatic Ink

- Technology Solutions
  - Signature verification replacing manual processes
  - Positive Pay/Reverse Positive Pay/Image Positive Pay
  - Thumb print Verification
  - Online Banking/EFT/ACH
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- Daily reconciliation
- Internal controls (separation of duties)
- “Post no checks” restriction (debit block)
- Timely check return

- Image Security Features
  - Implementation of image changed ability to identify altered versus counterfeit items since original items imaged and destroyed
  - When only image is available, traditional paper check security features don’t provide effective protection
  - Image Analysis – Image Environment
    - Image-survivable Security Features (ICSF)
      - Two primary purposes:
        ✓ To authenticate an original document, and
        ✓ To deter fraud by thwarting different methods to alter or replicate checks
      - Remain effective after imaging
      - Use cryptographic techniques and security mark to automatically validate if:
        ✓ Check is authentic
        ✓ Check is unaltered
        ✓ Check is uncopied
        ✓ Check is properly authorized
    - Security marks can be added at various points
      - Commercial checks - Printed when check is issued
        ✓ Protect variable information such as Payee name and amount
      - Security feature interoperability
        ✓ Validates feature is present
        ✓ Validates check is not fraudulent
      - ICSF framework allows exchange of validation information
        ✓ Framework is flexible
        ✓ Processing can take place using any computer or scanner

4. Regulations, Guidance and Compliance

- Bank Secrecy Act/Anti-Money Laundering (BSA/AML)
  - Established requirements for recordkeeping and reporting by private individuals, banks, other financial institutions. BSA was designed to help identify the source, volume, and movement of currency and other monetary instruments transported or transmitted into or out of the United States or deposited in financial institutions.
  - Money laundering: Complex process that involves three independent steps
    - Placement: First and most vulnerable stage of laundering money
      - Goal is to introduce unlawful proceeds into the financial system without attracting attention of financial institutions or law enforcement.
    - Layering: Second stage which involves moving funds around the financial system - often in complex series of transactions to create confusion and complicate the paper trail
    - Integration: Goal once funds are in the financial system and insulated through layering stage
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- Create the appearance of legality through additional transactions
  - The Money Laundering Control Act of 1986 augmented the BSA’s effectiveness by adding the interrelated sections to the Federal Deposit Insurance Act (FDIA) and the Federal Credit Union Act (FCUA). The Money Laundering Control Act of 1986 imposes criminal liability on a person or financial institution that knowingly assists in the laundering of money, or that structures transactions to avoid reporting them.
  - Suspicious Activity Report (SAR) was developed in 1996 to be used by all banking organizations in the United States.
    - Banking organizations required to file a SAR whenever a known or suspected criminal violation of federal law, or a suspicious transaction is detected that is related to money laundering activity or violation of BSA
    - Among other things, the USA PATRIOT Act criminalized the financing of terrorism and augmented the existing BSA framework

- Federal Financial Institutions Examination Council (FFIEC)
  - Formal interagency body that prescribes uniform principles, standards, and report forms for the federal examination of financial institutions
  - Empowered by various agencies including: the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), and the Consumer Financial Protection Bureau (CFPB)
  - Makes recommendations to promote uniformity in the supervision of financial institutions

- FFIEC guidance is issued in the form of handbooks such as FFIEC IT Examination Handbook (IT Handbook) and booklets such as the “Retail Payment Systems Booklet”
  - Retail Payment Systems Booklet provides examination guidance in three main sections covering:
    - Retail Payment Systems Overview: Provides background information on typical retail payments that involve use of various retail payment instruments/access devices (e.g., checks, ACH, card, phones, internet, etc.).
    - Payment Instruments, Clearing, and Settlement: Provides overview of various payment instruments and clearing and settlement processes used for different retail payment systems including:
      - Check-based payments, check clearing houses, the automated clearing house (ACH), card-based electronic payments, and emerging retail payment technologies
    - Retail Payment Systems Risk Management: Addresses risk in retail payment systems and appropriate risk management processes that identify, measure, monitor, and limit risks
  - See Exhibit 17 at the end of this Guide for an overview of selected FFIEC handbooks and booklets that are resources for the NCP Exam
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- Table included provides a description of the guidance in each document
- Lists key points to study
  - FFIEC guidance documents are available for download here: https://ithandbook.ffiec.gov/

- FFIEC also outlines several types of retail payments risk including:
  - Strategic Risk
    - Associated with financial institution’s mission and future business plans
      - Includes plans for entering new business lines, expanding existing services through mergers and acquisitions, and enhancing infrastructure
    - Emerging technologies for retail payments
      - Need for payment strategies in overall strategic planning processes
  - Preventive Measures
    - Strategic planning process that addresses retail payment business goals and objectives including supporting IT components
    - Third-party service providers;
      - Need comprehensive planning / vendor management
  - Credit Risk
    - Arises when a party will not settle an obligation for full value
      - Compare to an extension of credit
    - Retail payments have specific settlement process
      - Depends on the entities involved
      - Multiple financial institutions, third-party entities, as well as the payer and payee
  - Preventive Measures
    - Require limits (deposit and transaction)
    - Require pre-funding for credit originators
    - Require adequate risk-based reserves for debit originators
    - Financial benchmarks and reporting
    - Credit checks and background checks
  - Reputation Risk
    - Caused by perceived / real breaches in ability to conduct business securely and responsibly
      - Negative publicity regarding an institution’s business practices
      - Can lead to loss of revenue or litigation
    - Retail payment-related systems linked to
      - Consumer expectations regarding the delivery of retail payment services
      - Institution’s ability to meet its regulatory and consumer protection obligation
  - Financial institution responsible for risks associated with activities of third-party service providers
    - Operational failures / system disruptions
    - Lack of appropriate security and privacy policies resulting in release of customer information by service provider
  - Preventive Measures
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- Carefully review all contracts
- Ensure management oversight of third-party service providers

Operational Risk
  - Risk of loss resulting from inadequate or failed internal processes, people and systems, or external events. Can arise from a technology failure, human or technical errors in financial models and reporting, or other internal control system deficiencies
  - Improper Administration
    - Weak or ineffective controls
    - Increasing chance of errors, fraud and security breach
  - Losses related to errors
    - Result in delayed, duplicated or otherwise erroneous presentments or postings
  - Other Operational Issues
    - Communications Failure
    - Disaster
    - Hardware Failure / Power Failure
    - Software Failure
    - Human Error
    - Staffing Issues

Preventive Measures
  - Qualified/ Trained Staff
  - Policies and Procedures
  - Monitoring and Auditing

Legal (Compliance) Risk
  - Arises from failure to comply with statutory or regulatory obligations
  - Legal Compliance
    - Check Law - UCC Articles 3 and 4
    - Litigations
  - Regulatory Compliance
    - Reg CC and Reg J
    - FFIEC Guidance
  - Rules / Network Compliance
    - Clearing House Rules / Agreements
    - FRB Operating Circular 3
    - Image Exchange Rules / Agreements
  - Gramm-Leach-Bliley Act-1999 (GLBA) – Additional legal/compliance risks
    - Requirement to explain information-sharing practices to customers, and
    - To safeguard customer information

Preventive Measures
  - Be aware of changing legal and regulatory requirements, as well as new network rules that might create unexpected liability
  - Review processing arrangements with third-party service providers and originators to ensure that all such arrangements are governed by clearly written contracts which define outsourced responsibilities and liabilities

Liquidity Risk
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- Current and potential risk to earnings or capital arising from a financial institution’s inability to meet its obligations when they come due without incurring unacceptable losses
  - Related to payment systems when financial institution cannot settle an obligation for full value when it is due but rather at some unspecified time in the future
  - May cause other financial institutions to be unable to settle their exchanges
    ✓ Similar to the “domino” effect
- Liquidity problems can result in:
  - Lost opportunity costs
  - Defaults on other obligations
  - Costs associated with obtaining the funds from an alternative source

- Disaster Recovery / Business Resumption Plan
  - Contingency Planning - FFIEC Risk Assessment Guidance
    - Business Resumption Plan
      - Business resumption and incident response plans
      - Proactively update these plans before an incident occurs or auditors or examiners “bring it to your attention”
    - Disaster Recovery
      - Develop, implement and test appropriate disaster recovery and business continuity plans
      - Business Continuity Plan (BCP) - Establishes the basis for financial institution to recover and resume business processes when operations are unexpectedly disrupted
      - Capable of maintaining acceptable retail payment-related customer service levels
  - Business continuity plans based on:
    - Business impact analyses
    - Relative importance of retail payment system products and services
  - Business Continuity Considerations
    - Power Failure
      - Loss of power needed to process checks
      - Alternate Processing Site
      - Backup Power Supply / UPS (Uninterruptible power system)
    - Hardware Failure
      - Adequate Backup
      - Regular Maintenance
      - Reliable Equipment
      - Responsive “trained” Service Technicians
    - Software Failure
      - Loss or disruption of computer programs needed to process checks
      - Adequate Backup Copies; Should be backed up and offsite
      - Limited Access
      - Secure Storage
      - Well Tested Software; Ensure software is tested prior to implementation
5. Remote Deposit Capture (RDC) and FFIEC Guidance

- RDC is a deposit delivery system not just a product or service
- FFIEC Guidance recommends:
  - Senior Management Involvement
    - Identify and Assess risks
      - Legal
      - Compliance
      - Reputation
      - Operational
    - Understand RDC compatibility with institution’s business strategies
    - Understand Return on Investment (ROI)
    - Understand ability to manage risks inherent in RDC
- Remote Deposit Capture Potential Risks
  - New risks such as presenting duplicate items
    - Duplicates can come from multiple channels including paper, image, ACH
    - Warranties protect against duplicates; found in all rules including:
      - ECCHO Rules
      - Reg CC
      - Federal Reserve’s OC3 and Regulation J
    - Similar risks in merchant and consumer capture
  - Risk Mitigation
    - Bank should have RDC customer agreements
      - Agreements critical in mitigating risk to financial institution
      - Must clearly identify each party’s roles, responsibilities, and liabilities
      - and define requirements and consequences of noncompliance.
    - Follow latest FFIEC guidance
    - Follow “Know Your Customer” guidelines
    - Teller procedures to examine checks for stale dates or stamps or other information
      - Franked – marked to indicate previously processed
      - May include language such as “Electronically Presented”, “Processed” or similar on original check
      - Indorsement(s)
        - Restrictive indorsements such as “For Deposit Only”, with bank name, account number, signature
    - Utilize technology for duplicate detection
  - Risk management: Legal and compliance
    - Customer controls
    - Information security guidelines
    - Multifactor authentication
    - Applicable law
      - Reg CC, Reg E, NACHA Rules, Check Law
    - Bank Secrecy Act, USA PATRIOT Act, OFAC
  - Risk management: Mitigation and controls
    - Risk management policies
    - Customer due diligence and suitability
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- Approval process
- Credit approval
- Insurance adequacy
  - Vendor due diligence and suitability
    - Agreements – partner not security or compliance officer
- Training for customers
  - Contracts and agreements
    - Acceptable items
    - Customer obligations; original item versus image
    - Customer internal controls
    - Customer procedures for image quality
    - Deposit thresholds
    - Funds availability
    - Governing law
    - Item retention and destruction
    - Liability, warranties indemnification and disputes
    - Performance standards for both financial institution and customer
    - Periodic audits
    - Roles and responsibilities
    - Termination policy

6. Suggestions for Further Study

- Bank Secrecy Act/Anti-Money Laundering (BSA/AML)
- Federal Financial Institution Examination Council (FFIEC) guidance
  http://www.ffcic.gov/
  - For specific FFIEC references:
  - Review Exhibit 17 at the end of this Guide, or
  - See links outlined here: https://www.eccho.org/ncpc_training

7. Review Questions

- The following questions are a review of key points covered in this section and may be used to further aid in the study of these topics. See “Section Four – Exhibits” - Exhibit 10 for the Answer Key.
  - Image survivable check security features are designed to do what?
  - Opening accounts at two or more institutions and using “the float time” of available funds to create fraudulent balances is known as what type of fraud?
  - What is a key reason the FFIEC guidance on remote deposit capture recommends strong contracts and customer agreements?
  - Under the UCC, if a check is determined to be altered (rather than counterfeit), the Paying Bank’s liability is minimized. Describe why this is true.
  - What is a Business Continuity Plan (BCP) and why would one be needed?
J. CHECK OPERATIONS

Learning Objective: The item processing environment highlighted in the following section includes various activities that generally occur once deposited items are accepted for processing. Common operational processing steps, typically referred to as Day 1 or Day 2 functions, are discussed. Note: The following functional overview includes common examples of the various processes. These processes may have different names and may differ from one institution to another or based on an individual’s experience. These are intended to be general descriptions only.

1. Overview

Day 1 functions generally include steps for processing incoming and outgoing cash letters and deposits prior to going into capture and posting processes. Day 2 functions generally support the handling and resolution of exception items that rejected from the capture process on Day 1.

This section will first cover the functions for processing in a traditional paper cash letter environment to establish a basic understanding and then will contrast those same basic functions to those performed in the more current image-capture environment.

- Traditional paper-capture environment: Physical checks are deposited and received at a branch or other bank location and then transported to the bank’s back office (Proof Department) for processing at various times throughout the day.

- Technology that supports image exchange has allowed great strides in the solutions which support processing physical checks, resulting in a more cost-effective and efficient check clearing system.

- Straight Through Processing – Refers to ability to receive and process transactions end-to-end utilizing an electronic and automated system without intervention.
  - Goal is to automate various processes to eliminate physical movement of paper and move to more electronic or “virtual” processes.
  - Benefits are generally faster and more cost-effective processes.
  - Most banks have implemented some form of image technology in place of traditional paper processes.

- Check deposits now being scanned at locations remote from the back office such as:
  - Branches
  - ATMs
  - Vaults
  - Internal departments
  - Customer locations
  - Individual customer depositors via mobile devices

- Scanned items are transmitted electronically to the back office for processing.

- Changes to the check processing landscape have resulted in the introduction of new operational processes, the retirement of obsolete processes, and a combination of both old and new depending on the level of image adoption within the bank.

2. Day 1 – Paper Item Processing Functions

- Receipt – Physical movement of paper cash letters
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- Figure 2.20 is a simple graphic representation of a physical paper cash letter file that contains three separate cash letters – each with one or more bundles of checks.

- In today’s image exchange process, the physical cash letter is now an electronic file (see the X9.100-187 image exchange standard for details)
  - File, cash letter and bundle header/control structure are very similar to the original paper cash letters (such as this illustration).
  - Individual items (paper checks) now have MICR data and indorsement information carried in the electronic records in the image cash letter. See part “K. Standards” in this section for details on image exchange records and formats.

Figure 2.20 Cash Letters and Bundles

File-1 with 3 Cash Letters
- Cash Letter #1
  - 3 Bundles
    - Forward Debit Item(s)
- Cash Letter #2
  - 1 Bundle
    - Forward Debit Item(s)
- Cash Letter #3
  - 2 Bundles
    - Forward Debit Item(s)

- Receipt between banks (inclearing or transit cash letters) or from the front office (ATM, vault, lockbox, branch POD) to the back office for processing generally includes various controls such as:
  - Confirmation of receipt
  - Verification of source and control totals
  - Hand off to Proof & Encoding, or
  - Prepare directly for capture

- Proof & Encoding – Prepares unencoded deposits from branches, internal departments, vault, ATMs, corporate deposits, etc. for the capture process. General steps would include:
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- Encode amount and missing MICR information
- Balancing - Verify transactions from branches, corporate depositors, ATMs, vaults, internal departments, etc. are in balance
  - Create deposit adjustments for customer and/or internal departments as needed to balance

- Setup – Process that reviews work that has already been encoded, either by Proof & Encoding staff or pre-encoded by customers and adds internal control documents to prepare for high-speed or low-speed capture process.
  - Proof & Encoding work: Already in trays and balanced with any backup documentation removed when delivered to Capture/Sort
  - Customer pre-encoded work: Encoded and balanced at the customer location and delivered to the back office separately from unencoded work.
    - Frequently these are corporate deposits and correspondent cash letters
    - Customer paperwork, tapes, totals, other backup documentation removed from batch and retained with batch for use on Day 2 as needed
    - Match physical checks delivered to cash letter listing for accuracy
    - Settlement account identified, and credit inserted into batch
    - Placed in trays then taken to Capture/Sort for sorting and balancing
  - Inclearing work: Usually delivered in secured bags with checks wrapped by bundle and includes cash letter listing
    - On-us cash letters
    - Match physical checks delivered to cash letter listing for accuracy
    - Settlement account is identified, and a credit inserted into batch
    - Placed in trays then taken to Capture/Sort for sorting and balancing
  - Special sorts: May be delivered to the bank encoded or unencoded but are identified and separated from the work-stream in order to be processed differently. May include:
    - Controlled Disbursement
    - Lockbox
    - “Special Handling” customer deposits
    - Large dollar item review

- Capture/Sort – Process where the MICR line is mechanically read by various types of capture equipment (e.g.; IBM 3890, 7780/iTRAN, others) to capture the MICR data information, segregate on-us items and control documents, and sort all other items according to transit destination. Basic steps would include:
  - Capture MICR data
  - Sort items based upon routing criteria
    - Routing number on the item plus sort pattern requirements
  - Control documents segregated for internal purposes
  - On-us items are segregated for additional fine sorting later for bulk file/statementing purposes or for exceptions processing on Day 2
  - Endorse backs of items with BOFD indorsement or subsequent indorsement based on the type of work
  - Microfilm or image capture the front and back of each item

- Reject Repair & Re-Entry – Process where items that could not be processed in the initial capture process are repaired to attempt to capture the MICR data information in a subsequent process that generally includes:
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- Strip, re-encode and low speed capture of items unable to be processed via the initial capture process workflow
- Re-encode MICR data on items which were read incorrectly or correct those that were encoded incorrectly
- Re-route items that require additional investigation to Exceptions area for next day processing

• Balancing – Control process that balances work that has been captured in order to verify cash letter or entry totals. Basic steps would include:
  - Review of financial totals for each transaction, batch and/or entry to ensure accuracy
  - Research any source vs. captured differences and resolve as appropriate
  - Research any transaction differences, make corrections or adjustments as needed before sending customer information for posting

• Transit Dispatch - Process of preparing and releasing cash letters for collection to other financial institutions.
  - Generally, this would include:
    o Preparation of items for dispatch that have completed the capture process
    o Ensure items are routed correctly to external financial institutions based upon captured MICR information
    o Ensure items are dispatched according to schedules determined by agreements and Float Management schedules

• Bulk File – A filing and temporary retention system for on-us items
  - At the completion of all Day 1 capture, balancing, and posting processes, an additional sort process is initiated to:
    o Re-sort all captured on-us items from the previous processing day into the appropriate cycles associated with statement cut-off date needed for statement enclosure
    o Retrieval and insertion into customer statements
      • See Statements discussion in Day 2 section

• DDA Posting
  - Part of the End of Day processing functions for check operations area
  - Includes sending all information about items processed that day to DDA system
    o End of day posting to customer accounts

3. Settlement, Reconciliation and Float Management:

At the conclusion of each processing day, all control totals from Day 1 functions must be verified against transactions that posted to the customer accounts and to the internal general ledger accounts.

• First layer of verification happens as part of end of day tasks in the Day 1 operations area, usually by the Balancing staff
  - Control totals are rolled up as a sum of all entries processed for that day
  - All credits must equal debits before processing can be determined to be complete

• Next layer of account verification happens on the following day and is not generally included in either Day 1 or Day 2 references
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- Many functions that occur post-Day 1 generate reports for this purpose and entire departmental areas exist solely to ensure that each day credits and debits for these accounts remain in balance

- Settlement – Facilitates the exchange of funds between banks for the value of cash letters sent and received
  - Each bank has its own process for assigning exchanges to internal general ledgers based upon its unique clearing relationships and internal requirements
    - Rules for what types of entries may be made (such as whether adjustments and/or returns may be included) and scheduled times by which all settlement entries must be completed vary based on the agreements and clearing house rules that governed a particular exchange of cash letters
  - Ensures the inclusion of entries for forward clearing, inclearing and returns cash letters as well as adjustment entries for each bank-to-bank relationship
  - Confirms that all settlement totals accurately reflect the actual value of items sent and received
    - Confirms settlement totals for items sent and received in Federal Reserve exchanges via a parallel but segregated process
  - Adjustments made as needed to settlement accounts for missing work, out of balance cash letters, etc.
  - Ensures that the bank funding for all external settlement accounts accurately reflects the confirmed value for those cash letters and is completed each day by the times dictated by the Federal Reserve

- Reconciliation – Compares internal control totals for items captured to credit and debit entries reflected in general ledger accounts. While the Balancing area performs a similar function on Day 1 prior to posting for both customer and internal accounts, Reconciliation focuses on control totals after posting primarily for internal accounts.
  - Verification that all incoming and outgoing cash letters were captured and settled each day by comparing internal general ledger capture totals to settlement account entries
  - Ensures that all debit and credit entries to general ledgers balance and offset each day
  - Collaboration with internal departments to resolve any differences according to internal accounting procedures

- Float Management – Performs a variety of functions based upon the bank’s captured item trends and specific product account requirements.
  - Analyzes capture trend data to determine most appropriate clearing scheme according to internal bank strategies and may include:
    - Volume of items to a specific endpoint
    - Average value of items to a specific endpoint
    - Least cost options for clearing and settling items
    - Settlement times
  - Determines item capture sort pattern configuration according to internal bank strategies and may include:
    - Hardware limitations (items per hour variations for high-/ medium-/ low-speed devices and number of devices available)
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- Operational capacity (hardware limitations plus available staff at a particular capture location to determine throughput by time of day)
- Check clearing analysis
- Operational efficiency opportunities
  - Collaborates with internal retail and commercial groups to define pricing and availability models for different bank products

4. Day 2 – Paper Item Processing Functions

- Exceptions: Any items which rejected from the posting process are subsequently listed on daily reports which are reviewed and researched for resolution the following morning. Due to the nature of the processes the Day 2 area may include more specialized staff to handle the specific tasks outlined below:
  - Review of on-us items that rejected from posting the previous processing day; Process generally includes these steps:
    - Repair missing or incorrect information as needed
    - Resubmit items for posting, or
    - Return item to the BOFD
    - Includes review of items for exception reasons such as stop payment items, non-sufficient funds, fraud review, selected signature verification and other conditions
  - Physical paper exception items are sorted out from all other on-us items by Capture staff and delivered to Exceptions area for manual review, research and resolution
    - Items $5,000 or more are kept segregated for special handling, and notification to the BOFD if applicable
  - Items are researched manually and decisioned to pay or return:
    - Items which are missing information required for posting are returned either to the customer who deposited them or to the bank which presented them
    - Items decisioned to “pay” are segregated, manually added together with all other “pay” items under one general ledger, and sent to Proof & Encoding to be reprocessed through Day 1 on that day’s business
    - Items decisioned to “return” are segregated, manually added together for balancing purposes, and are returned either to the customer who deposited them or to the bank which presented them
  - Items being returned which are $5,000 or more require an additional notification to the BOFD
    - Notice of Nonpayment requirement as outlined in Reg CC §229.33
  - Items being returned must have the reason for return clearly identified on the front of the item per Reg CC §229.30(d) and are routed to the BOFD by using the indorsement on the back of the physical item
  - Identification of the correct depositary bank in this process is critical to the proper and timely routing of the exception items

- Outgoing Returns
  - Completes the process begun in the Exceptions area for items which have been decisioned to “return”

- Incoming Returns – Receive and review incoming items which are being dishonored by the Paying Bank
May be either:
- Transit items deposited at the bank and sent out for collection to other financial institutions
- On-us items deposited by the bank’s customers

Timeframe for receiving return items back from Paying Bank varies based on:
- What business day the item was deposited at the bank
- What processing day the bank sent the item out for collection
- Whether the item was routed directly to the Paying Bank or if it was routed through a correspondent, or intermediary, or other institution

Physical paper return cash letters are processed on medium- or low-speed device by Capture staff and uploaded to the Incoming Returns system for manual review and research and resolution by the Incoming Returns area

Items are matched to the bank’s record of all items processed to determine the depositing account information and are either charged back to the depositing customer or re-presented to the Paying Bank to once again attempt collection:
- Items to be charged back to the depositing customer are added to a report sent back to Capture where printed advices are matched to the item being charged back, inserted in envelopes and mailed back to the depositing customer
- Items to be re-presented are segregated, manually added together for balancing purposes, and are sent to Proof & Encoding to be reprocessed through Day 1 on today’s business date
- Banks may provide business account holders the ability to define special instructions for disposition of incoming returns such as automatic re-presentation based on dollar value and type of exception

• Statement Process
- Items are pulled from Bulk File and sent to statements to be inserted into the printed customer statement envelopes
- Various types of statement products may be offered
  - Enclosure statement: Physical items are inserted including physical paper check and other enclosures
  - Safe-keeping statement: No physical checks included
    - Check number and dollar amount provided
    - Provide images of paid items
  - Online statement: Access account information and provide statement information via online access
  - Image statement: Image statements and special statement products such as CD Rom require only the addition of images which are retrieved from the bank’s image archive
- Note: Statement types listed here cover both paper and image environments. Image statement and Online statements have been introduced as image technology has become prevalent

5. Research and Adjustments - Paper Environment
- Research Request - If submitted via mainframe application, request is downloaded and put in a processing queue where operator retrieves the request
  - Request for a photo copy of DDA transactions, Statements, etc.
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- Operator gets the roll of film, puts it in a film unit, keys in the sequence number and then prints a photo copy of the item
- Photo copy and the downloaded request is then matched and stapled and sent to the requestor via interoffice mail
  - Request is to determine what occurred and provide entry to reverse if issue is found
  - Operator retrieves the request and looks up the transactions via the rolls of film, documents what occurred and prints out back up documentation.
  - Request is answered in the system as to findings and documentation is then mailed to the requestor via interoffice mail.
  - Tickets are generated to reverse and post correct entries
  - Issue is due to bank error - Another entry is made to the adjustments GL and the request is then turned over to adjustments to go collect the funds from the financial institution generating issue
  - Request is complicated, and requires intensive research
    - All items file may need to be searched to find a portion of what transpired and then each item researched on several rolls of film to piece the whole picture together

- Adjustments - Downloaded from Fed or other exchange partner and manually entered into system
  - Each adjustment case in the system can be opened via an operator keying in all the details
  - Can then be researched using online tools such as:
    - All items file
    - Mainframe deposit systems
  - May require making calls to other financial institutions
  - May require preparation and dispatch of manual letters to other institution(s) to obtain further information for investigation
  - Back up documentation: Some cases may need boxes of back up documentation from Day 1 balancing entries or proof entries to see if missing items were left in error with tapes and other tracer documents
  - Listed Not Enclosed (LNE’s), or missing items - Adjustment cases from other financial institutions for Enclosed Not Listed (ENL’s)
    - Boxes of back up documentation are needed to resolve these issues as well
  - Research to resolve adjustment cases can include going to film to find piggy-back items, or to reconstruct missing item cases or encoding errors to locate offsetting funds.
  - Once research is completed, manual tickets generated to reverse error or settle adjustments submitted by the Fed or from other direct exchange partners.

6. Day 1 - Image Exchange Process

- Receipt of Electronic Transmissions – Image Cash Letter (ICL) – Electronic file containing digital images of paper cash letter, including the MICR data record, indorsement records and check images (See examples of cash letter image views in Figure 2.22 in section K. Standards). The image cash letter is electronically transmitted from:
  - Sending bank to receiving bank for in clearing or transit cash letters
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- Internal image transmissions from front to the back office, frequently called “blocks” or “units of work” from sources such as image ATM, vault, lockbox, or POD (branch image capture)
- May be created and transmitted to centralized back office operation from other internal areas within bank or directly from a device or other customer location. Examples include:
  - Front counter branch image capture – a teller receives a customer deposit, scans the individual items on a desktop device, ensures the transaction contains eligible items and is in balance, and transmits all items in the transaction to a centralized application
  - Back counter branch image capture – a teller receives a customer deposit, ensures the transaction contains eligible items and is in balance, but sends the paper transaction to another station within the branch to be scanned and transmitted to the back office grouped along with all other work received at that branch
  - Image ATM – Automatically captured at point of deposit by device
  - Vault or Lockbox – Customer deposits are verified, balanced and scanned by bank personnel into electronic files and transmitted to a centralized application
  - Image Deposit products (such as Image Cash Letter or Remote Deposit Capture products) – customer deposits which are scanned by the customer into electronic files and transmitted directly to a centralized application, bypassing the front office
- See Product section for more examples of Image Deposit (Image Cash Letter) products and Remote Deposit Capture
- There are many software options now available to manage the electronic file receipt and confirmation process as well as new image functions prior to taking the electronic files into a virtual capture sort application such as:
  - Duplicate file detection
  - Verification of electronic control totals
  - Validation of accurate X9 file format based upon type of file (internal versus bank-to-bank) and image exchange agreements
- Any remaining paper items still physically moved to the back office:
  - Items ineligible for truncation; or
  - Paper deposits which do not yet have associated image processing capabilities
- **Unit of Work:** In an image environment, this may be individual or multiple transactions
  - Association of credits and debits comprising a complete and balanced transaction (one credit to one debit, one credit to multiple debits, multiple credits to one debit, multiple credits to multiple debits)
  - Based upon specific bank products and the degree to which a bank has converted traditional paper processes to image:
    - Individual transactions such as large corporate deposits or individual customer transactions from an ATM or branch network
    - Multiple transactions such as Vault, Lockbox or POD work which are cut off at either a volume limit or time of day schedule, created into an electronic file and transmitted to the back office
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- Setup – This process still exists for any remaining paper deposits, internal transactions or cash letters received: reviews work and adds internal control documents to prepare for capture process.
  - Many banks have moved from high speed capture devices (such as 3890 sorters) to medium- or low-speed devices (such as iTRAns or 7780s) as more items are truncated at the source (branch capture, remote deposit capture, etc.).
    - Additional steps for new operational image processing functions such as Regional Image Capture:
      - Prepare un-encoded paper deposits received from branches or internal bank department for image capture process
      - When implemented, replaces Proof & Encoding function (ensure items are in proper order, right side up, remove rubber bands and paper clips, encodes missing MICR information, makes corrections to transactions as needed to balance credits to debits) with remote Image Keying function (keying missing MICR information directly into the electronic work flow from an image instead of the physical item)

- Image Quality Analysis (IQA) and Code line Match – Image processing functions which interrogate the electronic items prior to virtual, or electronic, capture to ensure all items adhere to the accepted and defined quality standards for image exchange
  - Most systems utilize a combination of systematic image quality analysis (IQA) and manual staff review of suspect items:
    - Systematic first level rejection of any items based upon business rules parameters which are configurable by each bank
    - Manual second level review of any items based upon business rules parameters which are configurable by each bank
    - Items that fail IQA may be returned via Administrative Returns process
      - Note: Not all banks use the Administrative Return process
    - IQA may then be handled through adjustments process
  - Code line match process ensures that item’s electronic data record (MICR information) matches the visual representation of the original check MICR line shown on the image
  - Business rules parameters include:
    - Image quality requirements - Common image quality defects include:
      - Excessive skew – Image is not in proper alignment
      - Piggyback - Two or more documents are present and overlapped within the document image
      - Too light - Image not having a sufficient number of black pixels or sufficient “contrast”
      - Too dark - Image having too many black pixels or insufficient “brightness”
      - Streaks - Image contains one or more “dark” or “light” bands that extend horizontally across most of the document image
    - Based on image exchange standard:
      - Can reject file when all records are not properly sequenced
      - Can reject item if records are incomplete
    - Example: File contains an Image View Detail Record (Type 50) but not a corresponding Type 52 record.
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- Needed MICR information for items such as full-field versus incomplete MICR for transit items
- Some software solutions which include business rules functionality allow variable configuration by deposit for these parameters

- Electronic (Virtual) Capture - Basic functions for capturing item information are the same as for paper capture, but the hardware has changed to accommodate new image technology.
  - Files can be manually ingested into the virtual capture system or automatically processed once incoming files have passed verification (duplicate detection, X9 format, control totals)
  - Many image capture systems contain the functionality to systematically dictate processing instructions, or business rules, for specific units of work such as:
    - Special processing requirements
    - Assignment of virtual sort patterns by customer, time of day, type of work
    - Assignment of appropriate internal control documents
    - Full-field encoding requirements
    - Image quality parameters to be applied
    - Adjustment method
    - BOFD or subsequent indorsement to be applied
    - Automatic generation of system alerts for files that are received which do not fit the profile set up (examples include late files, multiple files received when a single file is the norm, files that exceed the average item or dollar count)
  - System “reads” electronic data record information for control totals and all items included on X9 file
  - Capture of front and back segments of electronic images
    - System appends data record with:
      - Processing sequence number
      - Appropriate indorsement (BOFD or subsequent)
  - Electronic items are “virtually sorted” by destination: on-us items are uploaded to the bank’s posting application and image archive while transit items are included in the creation of an outgoing Image Cash Letter (ICL) based upon routing criteria

- Image Reject Repair – Items that are missing pieces of required MICR information in order to be sent for posting now reject from the virtual capture process into a queue to be keyed from the images.
  - Key entry of missing or incorrect electronic data record information
  - Merge of “repaired” data records back into electronic work flow
  - Electronic “trapping” of items requiring additional investigation sent to Exceptions & Returns staff
    - Usually researched and processed next day
  - Duplicate Item Detection – Once data has been imaged, repaired if needed, and loaded to the Duplicate Item Data base, a review of recently processed items against history of items from all source channels is performed.
    - Suspect duplicates are presented on an image review screen along with the potential duplicate for operator review and decision
    - “True” duplicate items will result in an adjustment against the source of work
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- Depending on timing and possibly agreements, can be sent to the presenting bank as either a return or adjustment

- Image Balancing – An image-enabled balancing area is typically a combination of more than one previous function from a traditional paper-capture environment:
  - Branch capture workflow
    - Balance individual transactions and create correction entries as needed
    - Similar to a paper proof operator function
  - Image deposit and inclearing image cash letter workflows
    - Ensure customer-created X9 file contains all needed information and is not a duplicate
    - Similar to paper receipt functions done by corrections and balancing staff
    - Some systems electronically insert an electronic “deposit ticket” control record based upon business rules set up for that customer
    - Some systems also can systematically create adjustments directly back to the customer for reasons such as ineligible items enclosed and poor quality or missing images
  - Incoming work that is out-of-balance at a file level can be systematically rejected prior to processing

- File Transmission – Verify information, create and transmit outgoing image cash letters (ICLs)
  - Bank may find it more efficient operationally to combine the function of transmitting outgoing image cash letters with that of ingesting incoming X9 and image cash letter files, creating a new “Command Center” area within the operations group
    - In a paper environment, transit cash letters frequently were dispatched without having completed the balancing process requiring adjustments to totals.
    - In the image environment, adjustments to totals are much more infrequent due to:
      - Increased efficiency that comes with working from images on a terminal instead of physically retrieving paper items from other areas
      - High degree of automation that speeds up throughput by eliminating stops/starts in the process (sorter jams, out-of-balance conditions, etc.)
      - Elimination of sequential handoffs from area to area (the next process cannot begin until the previous group/area has completed their tasks)
  - Once verified, the image exchange system will:
    - Query captured item information
    - Attach the associated images and addenda records to create X9 formatted outgoing image cash letter
    - Based upon each endpoint
    - While the industry uses the X9 standard to identify files mandated to conform to the X9.100-187 standard, the actual format contains fields and records of information that may be reviewed
      - Can vary by bank usage and/or agreements; May not be uniform across all banks for all purposes
  - Manage file transmission schedule based upon endpoint
Many software options now available to manage the electronic file creation and transmission processes:
  - Duplicate item and file detection and prevention
  - Verification of electronic control totals prior to transmitting
  - Automated attachment of images to data records and verification of match
  - Validation of accurate X9 file format based upon:
    - Type of file (internal versus bank-to-bank)
    - Image exchange agreements

- Bulk File – No longer a physical aspect for filing and temporary retention of on-us items, but is handled primarily within the online bank systems

- After virtual item capture, complete balancing, and posting processes at end of day
  - Segment on-us items by statement requirements based upon account:
    - Requirements by statement product are identified by codes set up in each account profile in the bank’s DDA system
    - Image statements (and special statement products such as CDRom) requiring only images are set up to look in the bank’s image archive for items drawn on these accounts
      - On the statement drop date, statement file becomes a “pick list” against the archive
    - Enclosure statements are identified as needing physical items for an insertion process when those statements cycle
      - Set up to ensure either the original or replacement document is available based upon a bank’s specific product requirements:
        - Items received by the bank as images will be directed into an IRD print queue to have replacement documents created which will then be retained in Bulk File the same as was done in the traditional paper environment
        - Items truncated during capture by the bank may be sorted the same as was done in the traditional paper environment and retained in Bulk File until statementing
    - Retrieval of physical items and insertion into customer statements
      - See Statements in Day 2 section

7. Settlement, Reconciliation and Float Management
   - Functions remain essentially the same as described in the paper environment
     - See Settlement, Reconciliation and Float Management in “3. Settlement, Reconciliation and Float Management” above

8. Day 2 Exceptions – Image Process
   - Exceptions area - Same as in the paper environment, but implementations of image-based applications for virtual capture, image archive and exception item review enable higher degree of automation within the process as well as faster throughput
   - Combination of paper and electronic processes still supported for banks in varying stages of image enablement
     - Images of exception items are systematically downloaded into the image Day 2 system for review, research and resolution by the Exceptions area
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- Items $5,000 or more are systematically identified for special handling, and notification to the BOFD if applicable
  - Items are researched online and decisioned to pay or return:
    - Items decisioned to “pay” are systematically uploaded into the workflow of all other items being processed on today’s business with appropriate system-generated control documents and totals, eliminating the need to physically reprocess through Proof & Encoding and recapture
    - Items decisioned to “return” are directed back either to the customer who deposited them or to the bank which presented them
      - Can be reconverted back into paper following rules for creating image replacement documents if the bank does not have Return Image Cash Letter (ICLR) functionality
      - Can be added to a Return Image Cash Letter (ICLR) and sent electronically back to the BOFD observing all required deadlines
  - Items $5,000 or more require an additional notification to the BOFD
    - Notice of Nonpayment as required under Reg CC
  - Items being returned must have the reason for return clearly identified on the front of the item per Reg CC
    - Routed to the BOFD by using the indorsement on the back of the physical item
  - For image returns, return reason code is in the Return Record (Type 31).

- Outgoing Returns – Completes the process begun in the Exceptions area
  - For items which have been decisioned to “return”
    - Creates the ICLR or return IRD

- Incoming Returns – Functions of the Incoming Returns area are the same as in the paper environment, but implementations of image-based applications for virtual capture, image archive and exception item review enable higher degree of automation within the process as well as faster throughput.
  - Timeframe for receiving return items back from a Paying Bank has changed from the traditional paper environment:
    - Electronic transmissions - item was sent in an image cash letter (ICL) directly to the Paying Bank or routed through an intermediary such as the Federal Reserve Bank, should process substantially faster due to the elimination of ground couriers and air transportation between banks
    - Federal Reserve Bank eliminated the category of “non-local” in 2010 when determining the geographical relationship between banks
  - Image return items are systematically loaded directly into the image Day 2 system:
    - Matched to the bank’s record of the depositing account information
      - Either charged back to the depositing customer or re-presented to the Paying Bank to once again attempt collection
    - Images of items to be charged back to the depositing customer are added to printed advices, inserted in envelopes, and mailed back to the depositing customer, or
      - Replacement documents may be used to reconvert the images back into paper items and add to printed advices, following the same process used in the paper environment
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- Image items to be re-presented are systematically uploaded into the workflow of all other items being processed on today’s business with appropriate system
  - Generated control documents and totals, eliminating the need to physically reprocess through Proof & Encoding

9. Research and Adjustments – Image environment

- Research Request - If submitted via mainframe application and request is downloaded and put in a processing queue.
  - Photo copy requests
    - System automatically does an image retrieval in the image archive
    - The image is submitted via email to the requestor if email address is in the profile or
    - Automatically printed along with the mail code information of the requestor and sent via interoffice mail
  - Request is to determine what occurred and provide entry to reverse if issue is found
    - All information on the transaction is loaded into the system or can be researched via the system
    - Resolution is identified and input into the system
    - System emails or delivers information to the requestor

- Adjustments
  - Image exchange has reduced the volume of adjustments as the items are no longer handled via multiple passes on sorters
  - Adjustments downloaded from Fed or partner and entered into system manually.
    - System assigns case and queue to operators
    - System obtains images, all items information, addenda data for items and presents to an operator
    - System generates settlement entries to clients and financial institutions
    - System generates letters
    - System generates cases to be uploaded to Fed and exchange partners

10. Review Questions

- The following questions are a review of key points covered in this section and may be used to further aid in the study of these topics. See “Section Four – Exhibits” - Exhibit 10 for the Answer Key.
  - Check processing operations are typically divided into Day 1 and Day 2 functions. List and describe three processes that typically occur on Day 1.
  - What is IQA and why is it used in check processing?
  - What is the goal of straight-through processing?
  - What are examples of poor image quality?
  - List and describe three types of bank statements.
K. STANDARDS

Learning Objective: This section provides an overview and purpose of the various standards that support check payments processing both in paper format, such as the MICR standards and the standard for the substitute check, and the image formats that support electronic check image exchange.

1. Overview – ANSI Standards and Formats
   - Accredited standards body for financial services is Accredited Standards Committee (ASC) X9, Inc., commonly referred to as X9
     - X9 creates American National Standards (ANS)
     - Standards accredited by American National Standards Institute (ANSI) and can be obtained from X9 or ANSI at: www.X9.org or at: www.ansi.org

2. Following standards are commonly used in the check payments system and are now referenced in Regulation CC for the substitute check, paper check and electronic check and electronic returned check
     - Provides the financial industry with a specification for an Image Replacement Document (IRD)
       - Standard for a machine-readable substitute document created from the image that is made from the front and back of the original check
       - Magnetic ink in the MICR line
         - Standard states the use of magnetic ink is not required if the IRD is created for a paid item that is returned to the issuing institution’s customer as a properly paid item
         - E-13B MICR font characters may be printed in non-magnetic ink for this use
         - IRD must still conform to all other requirements of the standard
     - Substitute check is defined in Regulation CC:
       - Must conform in paper stock, dimension, and generally applicable industry standards
     - Current ANSI standards related to check creation and printing are followed and are referenced in this standard
     - X9.100-140 standard defines an IRD which can be used as a substitute check as defined in Regulation CC
     - For return IRD’s, return reason codes were defined in Annex A Return Reason Codes, Code Description Region 7F Text and Overlay Abbreviations
       - Those codes are now contained in the ANSI X9.100-188 standard
         - Return reason codes that were defined within the ANSI X9.100-140 will be removed in future releases of this standard
   - Figure 2.21 shows sample front and back views of a forward presentment IRD with the following notations:
     - Forward Subsequent IRD – Front View
       - Legal Legend
       - Reconverting Bank information (Creating institution)
       - Truncating Bank information (Original truncating institution)
       - MICR line (from original check)
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- Original scanned front (clipped area indicated)
- Substitute check identified (“4” in EPC field in MICR line)
  - Forward Subsequent IRD – Back View
    - BOFD Endorsement Area
    - BOFD Endorsement for Original IRD
    - Subsequent Endorsements
      - Last four endorsements printed in oldest to newest sequence
  - See X9.100-140 standard for additional views and more complete information about the image replacement document (IRD)

Figure 2.21 Forward Subsequent IRD – Front and Back Views

Source: X9.100-140 standard, Accredited Standards Committee - X9, Incorporate
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  - Establishes the placement and location for printing MICR ink on checks, drafts and other documents intended for automated processing
    - Refer to Figures 2.3 and 2.4 for MICR examples
  - Used on documents to be read by magnetic ink character recognition
    - Band along bottom edge reserved for magnetic encoding
    - Band divided into character spaces, organized into several areas or fields
  - Common fields with fixed format for all users are:
    - Amount Field
    - Routing Field and
    - Optional EPC field
  - Variable fields
    - On-Us Field - format determined by needs of issuing financial institution
    - Auxiliary On-Us Field may appear at extreme left side on larger check

  - Establishes assignment and management of External Processing Code field or EPC
    - One MICR digit which conveys special information for the correct handling or routing of a check or check data to financial institutions or other processors
  - Codes used for qualified returns, identification of IRDs and identification of RCCs
  - Selected values are listed here; other values may be for characters that have been retired for are reserved for future use; See X9.100-160-2 standard for complete information
    - Character value ‘2’ – Identify return items that can be processed within the forward presentment system and delivered directly to the BOFD
    - Character value ‘4’ – Assigned for usage in creation of a forward or return IRD conforming to the ANSI X9.100-140 standard
    - Character value ‘5’ – Assigned for usage in the creation of a return IRD conforming to the ANSI X9.100-140 standard
    - Character value ‘6’ – Assigned for usage as an identifier of Remotely Created Checks (RCCs) (unsigned drafts – RCCs are not signed by the drawer)

- **ANSI X9.100-187 “Electronic Exchange of Check and Image Data”**
  - Provides financial industry with format necessary to perform electronic check exchange with or without images
    - Facilitates electronic movement or exchange of check-related data and images
      - For the purposes of forward check presentment, IRD creation, customer deposits and returns processing
  - Includes annexes defining both required (normative) and informational (informative) definitions and codes to support the standard
    - Annexes A, B, C, D and E are normative
      - Considered part of the standard
    - All remaining annexes are informative only
Not considered part of the standard

- Supports multiple check clearing alternatives such as bank-to-bank or bank-to-switch exchanges
- Modified from its original content to allow check images to be linked to and transmitted along with the (financial) posting data
- X9.100-187 standard, including normative annexes, establishes file sequences, record types, and field formats to be used for electronic exchange of check
  MICR line data and check images in the form of cash letters
  o Utilizes a cash letter structure to support the exchange of posting data only, posting data and check images, or posting data followed by an additional data and image file
- File is comprised entirely of variable length records

Selected X9.100-187 Records

- File level controls: File Header Record (Type 01) is associated with the File Control Record (Type 99)
  o File Header Record (Type 01): First record of file containing:
    • Origin / Destination Routing Numbers and Names
    • Creation Date and Time
  o File Control Record (Type 99): Contains file control information:
    • Cash Letter count
    • Item count
    • Total amount

- Cash Letter level controls: Cash Letter Header Record (Type 10) is associated with the Cash Letter Control Record (Type 90)
  o Cash Letter Header Record (Type 10): First record of cash letter containing:
    • Destination and ECE Institution Routing Numbers
    ✓ ECE Institution is the Electronic Check Exchange Institution
    • Various dates and time and codes to indicate:
      ✓ Forward (01) or Return (03) cash letter
      ✓ Inclusion (or “to follow”) image records
      ✓ Type of return
  o Cash Letter Control Record (Type 90): Provides control totals for cash letter including:
    • Bundle Count
    • Item Count
    • Total Amount

- Bundle level controls: Bundle Header Record (Type 20) associated with Bundle Control Record (Type 70)
  o Bundle Header Record (Type 20): First record of bundle containing:
    • Destination and ECE Institution Routing Numbers
    • Various dates
    • Bundle ID and Sequence Number
    • Cycle Number
    • Code indicates forward or return bundle (Not mixed in same cash letter)
  o Bundle Control Record (Type 70): Provides control totals in bundle for:
    • Item count
    • Total amount
    • Images within Bundle count
Cash Item Details: Forward presentment (20-series records)
- Check Detail Record (Type 25): One record for each check containing:
  - Information from MICR line of check
  - ECE Institution Item Sequence Number
  - Codes to indicate:
    - Type of Documentation associated with this check
    - Type of returns accepted
    - Archive available
    - Whether and how MICR line repaired
  - For business-sized check, would carry the aux-on us field in this record
- Check Detail Addendum A Record (Type 26): Associated with previous Check Detail Record
  - Multiple Type 26 records if check re-presented
  - Identifies/provides information on return location for customer returns
    - Typically, this is the BOFD routing information
  - Fields conform to Reg CC requirements
  - Codes indicate:
    - Whether / how MICR line repaired
    - Institution that truncated original check (Truncation indicator set to ‘Y’); Note: Only one truncation indicator set to ‘Y’
    - Note: If value of ‘4’ in EPC field, indicates this is an image of a substitute check
    - ALL truncation indicators would be set to ‘N’
- Check Detail Addendum C Record (Type 28): Associated with previous Check Detail Record
  - May have multiple Type 28 records – subsequent endorsers
  - Fields conform to Reg CC and other endorsement requirements (e.g.; ECCHO Rules)
  - Record carries codes to indicate
    - Institution that truncated original check
    - Whether / how MICR line repaired
    - Defines bank’s role in collection process
    - Carries Return Reason (on re-presented item)
  - Two purposes for Type 28 record
    - Contains Return Reason from prior Type 35 record (for a re-presented item)
    - For subsequent indorsements: Identifies and provides information for each endorsing institution; required for IRD creation

Cash Item Details: Returns (30-series records)
- Return Record (Type 31): One record for each return item
- Created by Paying Bank or returning institution containing:
  - Information from Check Detail Record or original check
  - Forward Bundle Date
  - ECE Institution Item Sequence Number
  - Codes to indicate:
    - Return Reason
    - Archive available
    - Number of Times Returned
SECTION TWO – TRAINING GUIDE

- Return Addendum B Record (Type 33): Used in conjunction with Return Record (Type 31)
  - May contain Auxiliary On-Us field (which is contained in Check Detail Record (Type 25) in forward presentment file)
    ✓ Auxiliary On-Us: Optional field left of routing number field on the MICR line of the check
  - Used on business-sized checks for:
    ✓ Consecutive serial numbers
    ✓ Account control information
    ✓ Product codes/ other information

- Return Addendum A Record (Type 32): Mirrors Check Detail Addendum A Record (Type 26)
  - Type 26 record identifies return location

- Return Addendum D Record (Type 35): Contains:
  - Paying Bank identification
  - Return Reason code
    ✓ Same Return Reason as Return Record (Type 31)
  - For re-presented items: Record mirrors Check Detail Addendum C Record (Type 28) which
    ✓ Identifies and provides information for each subsequent endorsing institution in the forward collection process

- Image View Records: Detail and Data Records
  - Image View Detail (Type 50) / Image View Data (Type 52) Records
    - Convey image data and image of the check
      ✓ On forward collection for Check Detail Record (Type 25)
      ✓ On return for Return Record (Type 31)
    - Records occur together; for each check imaged, must have:
      ✓ Pair of 50/52 records for front view; and
      ✓ Pair of 50/52 records for back view
      ✓ Partial views may be permitted by agreement

- Type 50 Record – Image view
  - Contains codes that describe the image including:
    ✓ Format and Compression
    ✓ View side (front or rear)
    ✓ View descriptor (full or partial view)
    ✓ Digital signature and security information, if included

- Type 52 Record – Image Data
  - Includes the image of the check and:
    ✓ Reference Key information
    ✓ Security information
    ✓ Clipping information
    ✓ Digital signature, if included

- Two examples are shown in Figure 2.22 to illustrate electronic records in a standard X9.100-187 cash letter file
  - First graphic: Data string as stored in the electronic image cash letter (ICL) and how that data is stored/viewed in the cash letter header (Type 10) and control (Type 90) records; and
  - Second graphic: Data as stored/viewed in Check Detail Record (Type 25)
Examples shown are illustrated as may be viewed using an image viewer product (Source: www.AllMyPapers.com).

Data string as it is stored in image cash letter (ICL):

0103T061000146256074974201608011158NFRB Atlanta AnyBank 1 1

**Figure 2.22 Examples of Selected Image Views of Cash Letter Records**

<table>
<thead>
<tr>
<th>Cash Letter Header (Type 10) and Cash Letter Control (Type 90) Records</th>
</tr>
</thead>
<tbody>
<tr>
<td>File Header</td>
</tr>
<tr>
<td>Cash Letter 1 - ADVL5802</td>
</tr>
<tr>
<td>Bundle 1 - 1115802</td>
</tr>
<tr>
<td>Bundle 2 - 1115802</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
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</tr>
<tr>
<td>Bundle 2 - 1115802</td>
</tr>
</tbody>
</table>

Source: www.AllMyPapers.com
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- ANSI X9.100-188 "Return Reasons for Check Image Exchange and IRDs"
  - Provides list of Return Reason codes that are used for image exchange and the creation of IRDs
    - Codes originally defined in X9.100-187 and X9.100-140 standards
      - Separation of the Return Reason Codes into its own standard facilitates future updates and supports implementation by banks and vendors when codes are added or updated
    - X9.100-188 standard includes an Annex (informational appendix that discusses proper use of return codes
    - Standard does not address implementation considerations

3. Other Standards
- Many other X9 standards and technical reports are referenced by the various image exchange and IRD standards
  - To learn more about standards or to obtain a copy of a currently available standard and/or technical report, go to www.x9.org
- Standards:
  - X9.100-10: Paper for MICR Documents
  - X9.100-20: Print and Test Specifications for Magnetic Ink Printing (MICR)
  - X9.100-110 (X9.7): Document Imaging Compatibility
  - X9.100-111: Physical Check Endorsements
  - X9.100-151: Check Correction Strips
- Technical Reports:
  - X9 TR 2: Understanding, Designing and Producing Checks
  - X9 TR 6: Guide to Quality MICR Printing and Evaluation
  - X9 TR 8: Check Security
  - X9 TR 33: Check Image Quality Assurance and Processes
  - X9 TR 100: Organization of Check-related Payments Standards

- Not a standard but a companion document to the X9.100-187 standard
  - See Technical Reports section that follows for a discussion of the UCD which is now defined as X9 TR 47 technical report

5. Technical Reports
- X9 TR 2-2005 Understanding, Designing and Producing Checks
  - Guideline only - not as restrictive as a standard
  - Purpose is to promote uniformity in design and production of checks through widespread distribution of this report to check designers and suppliers, as well as to financial institutions and commercial check users
    - Recommended to improve processing and handling of checks throughout payments system
    - Recommendations described in report are compatible with the existing check standards and are designed to supplement the standards
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- Report covers various topics including:
  - Definition and overview of the check
  - Life cycle of a check
  - Minimum completion requirements for:
    - Amount, Payor, Payee, Date
  - Best practices in check design
  - Check processing technologies
  - MICR and MICR usage in:
    - Serial number and Routing field
  - Legal and regulatory requirements
  - Personal and Business size checks

- X9 TR 47 Universal Companion Document Industry Adoption of X9.100-187
  - UCD released in 2016 as a new X9 technical report
    - TR 47 is a free document available at http://www.X9.org
  - Purpose is to clarify how institutions should apply the standard for populating data files with check information to be exchanged
  - Formalizes industry standard for check image exchange using the X9.100-187 standard format and compilation of industry norms
    - Does not replace X9.100-187 standard
  - Designed to clarify how financial institutions should use the standard
    - For all necessary payment data exchanged between collecting and paying institutions
  - Standard defines which records must be used for check image exchange (forward and return)
    - UCD explains how to populate the fields in those records
    - Outlines each record deemed to have critical payment data and lists all associated fields contained in the standard
    - Describes any unique field validations for the following exchanges:
      - Endpoint Exchange
      - Federal Reserve
      - SVPCO
      - Viewpointe
  - Use of this document requires all image exchange participants obtain, use and adhere to the record and field usage definitions detailed in the ANS X9.100-187 standard

6. Electronic Indorsements

- Uniform Commercial Code (UCC) and Regulation CC (Reg CC) place certain responsibilities regarding indorsements on the parties handling a check

- Indorsements may be:
  - Physical: Sprayed, printed or overlaid on the check, or
  - Carried electronically in the X9.100-187 file format or
  - Both

- For check converted to an image, the image retains any physical indorsements that were present however physical indorsement for the image creator will not appear in the image if the image is captured prior to the item being physically indorsed
To maintain a complete indorsement history, additional electronic indorsements may be included with each item in an X9.100-187 file.

Subsequent conversions of an item between electronic and paper form are also possible.

For electronic items converted back to paper form, Check 21 (Reg CC Subpart D) requires that previous indorsements be carried on the substitute check whether the party indorsed in physical or electronic form.

X9.100-187 file format has electronic record formats to:

- Meet the requirements of the IRD specifications
- Properly identify the purpose of the electronic indorsements
- Provide an indorsement audit trail
- Provides two ways for indorsements to be carried in the electronic records:
  - Physical indorsements on the check image contained in the Image View Data Record (Type 52)
  - Electronic information carried in each item’s related X9 detail and addendum records
    - Various record “types” contain fields required for maintaining indorsement information

Forward item records

- Check Detail Record (Type 25): One record for each check
  - Contains 15 fields with information from check’s MICR line
  - Item Sequence Number for this institution
  - Other codes
  - For business-sized check, would carry aux-on us field
- Check Detail Addendum A Record (Type 26)
  - First of three addendum records associated with previous Check Detail Record (Type 25)
    - May have multiple records when check re-presented
  - Contains 13 fields
  - Identifies/provides information on return location for customer returns - typically BOFD
  - Fields conform to Reg CC requirements
- Check Detail Addendum B Record (Type 27)
  - Second of three addendum records associated with previous Check Detail Record (Type 25)
  - Used only under clearing agreements
  - Contains 8 fields
  - Identifies a defined value for the length of the image reference key which is normally a variable value
- Check Detail Addendum C Record (Type 28)
  - Third of three addendum records associated with previous Check Detail Record (Type 25)
  - Contains 12 fields
  - Two key purposes: Return Reason when flipped from a prior 35 record on a re-presented item; and for subsequent indorsements
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✓ Shows bank’s role in collection process if additional financial institution(s) handled the item and provided indorsement(s)
✓ Generally, this is the indorsement information of a subsequent bank (intermediary) in the collection process
✓ If a returns consolidator agreement is in place, this would be the depository bank’s indorsement with an indicator

– Return item records
  o Return Record (Type 31): One record for each return
    • Contains 12 fields
    • Created by Paying Bank or returning institution containing information from Check Detail Record or original check
    • Codes to indicate return reason and number of times returned
  o Return Addendum A Record (Type 32)
    • First of four addendum records associated with Return Record (Type 31) - contains 13 fields
    ✓ Mirrors Check Detail Addendum A Record (Type 26) which identifies return location for customer returns
  o Return Addendum B Record (Type 33)
    • Second of four addendum records associated with Return Record (Type 31) - contains 6 fields
    ✓ Carries the Auxiliary On-Us field for business-sized checks which is found in Check Detail Record (Type 25) on Forward presentment file
  o Return Addendum C Record (Type 34)
    • Third of four addendum records associated with Return Record (Type 31) - contains 8 fields
    ✓ Mirrors the Type 27 record
    ✓ Used only under clearing agreements
    ✓ Identifies a defined value for the length of the image reference key which is normally a variable value
  o Return Addendum D Record (Type 35)
    • Fourth of four addendum records associated with Return Record (Type 31) - contains 12 fields
    ✓ Mirrors Check Detail Addendum C Record (Type 28), if any, which identifies information for each subsequent endorsing institution
    ✓ Paying Bank indorsement information and return reason
    ✓ Matches return reason in Type 31 record

– Understanding the use of these detail records is the key to understanding the process flow of an imaged check and its associated electronic indorsements

• For more information, see the currently available X9.100-187 standard.

7. Formatting On-Us and Aux On-Us Fields

• On-Us field: Located between Amount and Routing fields, based on ANSI X9.100-160 standard
  – Typically contains account number and optionally, serial number and/or transaction code
  – Requires one on-us symbol to right of Account Number
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- Allows for one additional on-us symbol
- Can contain up to three discrete data fields
  - Maximum number of positions in field is 19 with one blank tolerance
  - Flexible design allows structure to vary from bank to bank

- ANSI X9.100-187, to accommodate variability of data and position of On-Us field, requires truncating bank to capture entire On-Us field from physical check
  - Truncating bank places entire On-Us field from physical check into On-Us field in image file
    - In same sequence as on physical check
    - On-Us symbol represented as forward slash (’/’)
    - Characters that cannot be interpreted are replaced with the non-read symbol of asterisk (’*’)
      - Spaces eliminated
      - Dashes included, unless agreed otherwise by exchanging institutions

- Aux On-Us Field: Optional field to the left of the Routing Field on the MICR line on business-sized checks generally used for the placement of consecutive serial numbers
  - Optional variable format field to the left of the routing field or the EPC when an external processing code is present
  - Data when present must be bracketed by On-Us symbols
    - Limited to 17 characters including the 2 required On-Us symbols
    - Supports 15 significant numerical digits or dashes
    - Dash symbol may be used as separator, but blank space serves the same purpose and is preferable
  - Note: Checks with Aux On-Us field are ineligible for conversion to ACH entries such as ARC, POP and BOC
    - NACHA Operating Rules (§ 2.5.13.3) state to be eligible must be a consumer account

8. Review Questions

- The following questions are a review of key points covered in this section and may be used to further aid in the study of these topics. See “Section Four – Exhibits” - Exhibit 10 for the Answer Key.
  - What standard is used to define the specifications for an Image Replacement Document (IRD)?
  - Must an IRD be encoded in magnetic ink in the MICR line to be considered a properly prepared legal equivalent of the original physical check?
  - What is “TR 47 Universal Companion Document Industry Adoption of X9.100-187”?
  - How does the UCD require a bank to identify itself in an X9 image cash letter?
  - A bank received a Check Detail Addendum A Record (Type 26). In returning this item, what X9 record(s) are “flipped” and must be included?
  - What is the EPC digit and how is it used?
L. EXCEPTIONS: RETURNS AND ADJUSTMENTS

**Learning Objective:** This section looks at the options for handled check exceptions. An exception in this context is a payment that is dishonored by the paying institution and will be returned unpaid or adjusted. Check exceptions can be handled as either a return item or as an adjustment claim.

Timing for return of an item is dictated by both the Uniform Commercial Code (midnight deadline) and by Regulation CC (for the expeditious return requirements). However, check payments law does not offer specifics regarding the identifying return reason codes nor does it offer provisions for adjustment claims. Return reason codes for check image returns are defined in industry standards along with the recommended usage for each code. And image exchange rules offer provisions for the handling of adjustments through the Federal Reserve Banks or through private sector adjustment providers. This section will discuss returns in some detail including why the correct use of return reason codes is important for the timely and proper resolution of check payment exceptions.

For more detail on check adjustments, please see part H. Image Exchange: Private Sector and Federal Reserve of this section which includes detail on the ECCHO and Federal Reserve rules provisions for adjustments, definitions of common adjustment types, a snapshot of current adjustment volumes, and a comparison of the most common Federal Reserve and ECCHO adjustments.

Following is an overview of returns and how those may be resolved using common return reason codes.

1. **Return versus Adjust?**

   - An exception has been identified and as the Paying Bank your return clocks are ticking. How do you determine which option to choose — return the item or file an adjustment claim?
   - **Return:** Decision to return a check versus handling as an adjustment claim must consider the timing;
     - To be considered timely, a return must meet both requirements:
       - Midnight deadline for UCC – midnight of the day after the day of presentment; and
       - Expeditious return requirements for Reg CC – received by the depositary bank by 2:00 pm local time the second day following day of presentment
     - Returns are faster especially if bank is not certain of the cause of the exception
       - Do not lose right to return (can make the deadline for a timely return)
         - In remote deposit capture (RDC) environment, speed is a consideration if bank is unsure of cause of duplicate (fraud versus an error)
     - But returns may have a negative impact on the depositing customer and/or drawer customer if error as caused by the banks
   - **Adjust:** Adjustments are bank-to-bank (may stay within the banking system)
     - Handled within banking system by areas familiar with process
     - Can minimize negative impact to both institutions’ customers, especially if the error was caused within the banking system (such as processing a duplicate file)
     - Can be less efficient than returning due to the added timing for research and the potential need to provide additional documentation prior to settlement
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- Added timing may cause bank to lose the right to return the item due to the missed deadlines for timely return
- Can be a significant issue if item is counterfeit or forged and not a simple duplicate error
  - See various adjustment options available through the Federal Reserve Bank (see online Check Adjustment Quick Reference Guide) or through private sector providers (see ECCHO Rules and Adjustment Matrix)

2. Overview of Returns:

Current statutory and regulatory laws governing check payments, Uniform Commercial Code and Regulation CC, do not list specific reasons for an item to be dishonored and returned

- Image exchange standard ANSI X9.100-188 provides list of return reasons and associated codes for image exchange
  - Use of these return reason codes has become standard industry practice
- ANSI X9.100-188 Return Reason codes and Record Types
  - Codes used in Return Record (Type 31); Return Addendum D Record (Type 35)
  - Return Reason may also be carried in the forward presentment Check Detail Addendum C Record (Type 28) that is associated with a previously returned and re-presented item

3. Legal Environment

- Under UCC, Paying Bank can return item for any reason if it is within the legal return time frame
- Reg CC does not define reason for returns
  - Return reason codes for image returns defined in industry standards (see X9.100-188 discussion) which includes the definitions and recommended usage for each code
- Legal return time frames
  - UCC – Paying Bank must return item by midnight of the day following presentment
  - Reg CC – Bank of First Deposit (BOFD) must receive return by 2:00 p.m. local time two days after presentment
- Reg CC [§229.31(e)] requires a Paying Bank identify the return and reason for return:
  - Paying bank returning a check must clearly indicate on the front of the check that it is a returned check and the reason for return
  - If returning a substitute check or an electronic returned check, must include this information such that the information would be retained on any subsequent substitute check
  - Note: Reg CC commentary states “Refer to Maker” is a permissible reason in appropriate cases
4. Types of Returns

- Two types of returns defined in image exchange: customer and administrative returns
  - Note: Most network exchanges do not allow both customer returns and returns for administrative reasons in the same return cash letter
- Customer returns: Distinguishes to presenting bank this is a dishonored item under check law
  - Generally, customer returns are items where an attempt was made to charge/post that item to customer’s account
  - Examples include returns for:
    - NSF
    - Stop pay
    - Closed account
- Administrative returns, or return for an administrative reason: Distinguishes to presenting bank this is an item returned for reason other than a dishonored item
  - May be handled internally by presenting bank rather than being charged to customer; can also be handled through adjustment process
  - If handled as return, must adhere to legal requirements for a return item including:
    - Timeliness
    - Proper delivery
    - Any required notifications
- Examples of administrative reasons for returns:
  - Poor quality image
  - Ineligible items
  - Not our item
  - Blank or missing image
  - Mismatched MICR
  - Duplicate item

5. Identification of Type of Return

- ANSI X9.100-188 standard allows for both Customer and Administrative reasons for return
- Some return reason codes used for both Customer and Administrative returns have the same meaning
- Following codes used as both Customer and Administrative returns:
  - ‘T’ Item cannot be re-presented (Exceeds number of allowed times item can be presented)
  - ‘U’ Unusable Image - Image could not be used for required business purpose; (e.g.; gross image defects, illegible item, etc.)
  - ‘V’ Image Fails Security Check
  - ‘Y’ Duplicate Presentment (Supporting documentation shall be readily available)
  - ‘2’ Does not conform to the Industry’s Universal Companion Document
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- ‘3’ Warranty Breach (includes Rule 8 & 9 claims)
- ‘4’ RCC Warranty Breach (Rule 8)
- ‘5’ Forged and Counterfeit Warranty Breach (Rule 9)
- ‘6’ Retired / Ineligible Routing Number

- To identify a customer or administrative types of return, the value in the Returns Indicator (Field 14) in the Cash Letter Header Record (Type 10) must be:
  - ‘R’: to identify a customer return
  - ‘E’: to identify an administrative return

- Two codes (‘I’ and ‘Q’) can be used in both Customer and Administrative returns with different meanings
  - Customer Return
    - ‘I’: Endorsement Missing
    - ‘Q’: Not Authorized (Includes Drafts)
  - Administrative Return
    - ‘I’: Image Missing
    - ‘Q’: Ineligible

6. Substitute Check (IRD) Returns

- ANSI X9.100-140 standard provides for the creation of an IRD. Original IRD Used for Return and Subsequent IRD Used for Return described in the standard
- Return IRDs: Similar to Forward IRDs except created in return process
- Contains all regions for a Forward IRD with some additions:
  - Return Reason code and short name text description contained in Conditional Return Reason Region, Region 7F
  - Text overlay placed over front of image
  - May also include Optional Qualified MICR Region

- ANSI X9.100-140 standard previously contained list of return reason codes to mirror the return reason codes in ANSI X9.100-187 image exchange standard
  - Return reasons for the IRD are now contained in the new ANSI X9.100-188 standard
  - IRD return information includes:
    - Return Reason Code
    - Code Description
    - Region 7F Short Name
    - Overlay Abbreviation

7. Return Reason Codes

- Most return reasons listed in the ANSI X9.100-188 standard have been in use for many years and are self-explanatory
- Meanings of other return reasons may not be obvious
  - Description of those codes now included in the ANSI X9.100-188 standard – “Annex A Proper Use of Return Reason Codes”
- See Exhibit 9 to this Guide with list of Return Reason Codes from the X9.100-188 standard; Reprinted with permission of Accredited Standards Committee X9, Inc.
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8. Return Reason Code "Y"
   - Used for claim related to Duplicate Presentment
   - Appears in both the Customer and Administrative list of return reason codes
   - Duplicates can be handled as return or adjustment
     - May depend on the facts and circumstances, seek legal counsel for advice
   - Legal Environment
     - Under industry regulations for image exchange, banks sending image (or substitute check) warrant receiver will not be asked to pay item it already paid
       - Method to collect on this warranty, not stated in rules or regulations
     - Returning duplicates could protect legal rights as long as within legal timeframe
       - After legal timeframes must be handled as adjustment
     - Items not duplicates (counterfeit, etc.) that are adjusted as duplicate can cause loss to Paying Bank, since right to return will have passed
   - Duplicate Environment
     - Early duplicates were caused within banking system
     - Duplicates today more likely to be caused by the customer – outside banking system
       - Example: RDC image sent and then original check deposited or cashed
         - Some may be errors but there is risk of fraudulent intent
     - Important to identify and handled correctly
   - Addition of Return Reason Code “Y” for Customer Returns
     - ANSI X9.100-187 updated in 2013 to include “Y” to Customer Return codes
       - Previously no customer return code for duplicate return, only for administrative return
       - Banks that wanted to return duplicates as customer returns were:
         - Using return reason code ‘Y’ regardless of standards; or
         - Using Refer to Maker or Refer to Image return reasons
       - Both the “Refer to Maker” and “Refer to Image” return reasons did not provide adequate descriptions
     - Inclusion of ‘Y’ as Customer Return reason code:
       - Provided more descriptive information to BOFD and/or its customer
       - Allowed banks to trap duplicate return reason for special handling, if needed
     - All return reason codes are now contained in ANSI X9.100-188 standard and those that were defined within other standards were removed
       - X9.100-188 standard is publicly available on the X9 website at www.x9.org

9. Review Questions
   - The following questions are a review of key points covered in this section and may be used to further aid in the study of these topics. See “Section Four – Exhibits” - Exhibit 10 for the Answer Key.
     - Which check payments regulation(s) outline detailed reasons for returns?
     - When creating an electronic return image file based on the current standard, which record, or records, must contain the return reason code?
     - What are two main types of returns?
In some cases, the same return reason code can be used for both a Customer and an Administrative return. What record and code(s) must be used in the electronic cash letter files to indicate whether a customer or an administrative return is being sent?

M. CHECK PRODUCTS

Learning Objective: Consumer and corporate check products will be covered in this section including the definition and general purpose and/or common use for each of the following: image cash letter; remote deposit capture; various types of checks, check conversion products, account reconciliation products, controlled disbursement, and remotely created checks.

1. Image Cash Letter (ICL):

An electronic representation of a paper cash letter, the image cash letter is used to transport check transaction data, including check images, between organizations and systems for the purposes of clearing the check payments.

- Electronic cash letter structured with basically the same information as the paper cash letter. Structure includes:
  - File header and control
  - Cash letter header and control
  - Bundle header and control
  - Detail records representing physical checks that include check information (i.e. MICR data), indorsement information and the image of the paper check (front and back)

- ICLs are typically batch files with significant volume of checks sent to the bank/processor, versus a remote deposit capture (RDC) process that typically sends a smaller volume of checks

- ICLs are formatted in the accepted industry standard created by X9 and its associated companion document
  - Contains and transports the image and MICR data captured from paper check transactions

- ICLs are used to transmit checks between customers and their banks, as well as between banks and/or Federal Reserve

- Image Cash Letter product is offered by many banks to their corporate and correspondent bank customers
  - Corporate and correspondent bank customers use ICLs for delivery of check deposits to their banks
  - ICLs are ideal for companies with centralized in-house receipt processing
    - Examples: An in-house lockbox at a utility company or a correspondent bank with in-house check processing operations
  - Customer needs to have ability to capture and transmit MICR data and check images
    - Banks offering this product may require customer to create a properly formatted ICL file in the X9 standard; or
    - Bank may provide their customer with software to reformat their data into the X9 file format; or
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- Bank may be willing to accept the data and do the reformatting.

- The benefits to the customer associated with ICLs are:
  - Reduced transportation costs
  - Reduce or eliminate trips to the bank to deposit checks
  - More efficient back-office processing
  - Later deposit cutoff time allowing more checks deposited on the same day as receipt
  - Faster return processing and notification due to faster initial deposits and clearing
  - Secure, private and safe electronic connections with the banks

- Cost savings to the customer include:
  - Consolidation of operations
  - Consolidation of reconciliation
  - Larger balances in a centralized account
  - Elimination of multiple accounts and the need to concentrate funds

2. Types of Checks

- “Check” is defined in Regulation CC and in the UCC, within the definition of a negotiable instrument. All checks under the following definitions are eligible items for image exchange or to create a Substitute Check:
  - Cashier check: Drawn on a bank -
    - Check that a bank draws on itself
      • Bank is both drawer and drawee
      • Signed by officer / employee of bank on behalf of the bank as drawer
    - A direct obligation of the bank
    - Lost or stolen Cashier’s check - file a Declaration of loss if:
      • Declarer is remitter or payee of check that lost possession of check
        ✓ Loss not result of transfer or lawful seizure
      • Filed claim is enforceable at the later of:
        ✓ Time the claim is asserted; or
        ✓ 90th day following the issue date of the check
      • Claim has no legal effect until enforceable
        ✓ Earliest date enforceable = 90th day after issue date
    - Until enforceable, obligated bank (issuer of cashier’s check) may still pay the check
      Generally provided for remittance purposes; common uses include payments that must be credited immediately upon receipt (Ex: Business, real estate transfers, tax payments, etc.)
  - Certified Check: Ordinary check presented by the drawer to the paying bank for “certification”
    - Certified by signature on the check of officer or other authorized employee of the bank, that:
      • Signature of the drawer on the check is genuine; and
      • Bank has set aside funds to pay or will pay check upon presentment
    - Not frequently used today
  - Government check: Instruments payable on demand and drawn by the U.S. government on the government itself
Generally regarded as checks, even though they are not drawn on a bank

- Money order: Draft that a person may purchase from a financial institution, post office or sales agent to pay a debt or transfer funds
- Traveler’s check: Payable on demand and drawn on or payable at or through a bank
  - Designated by the term “Traveler’s Check” or substantially similar term
  - Requires, as a condition of payment, a countersignature by a person whose specimen signature appears on the instrument
- Payable-Through draft: Drawn on the issuer, not the bank
  - Not an order on the payable through bank to pay the instrument, but merely designates that bank to present the draft to the drawee for payment
- Warrant: Issued by state or local government agencies
  - Treated as checks if they are payable on demand
  - Many are actually payable-through-drafts
  - Registered Warrants - Not a Check/Promise to pay (IOU)
- Remotely Created Check (RCC): Holder of a checking account authorizes a payee to draw a check on the account but does not actually sign the check
  - May also be called unsigned drafts
  - RCC is defined in Reg CC [229.2(fff)] as: “. . . a check that is not created by the paying bank and that does not bear a signature applied, or purported to be applied, by the person on whose account the check is drawn”
    - Warranty by BOFD depositary bank is established in Reg CC
    - Claim process provided through rules and OC 3 for unauthorized RCCs
    - To be valid under current check law, RCC must exist in paper form
  - Can be created for consumer and corporate accounts
  - Legitimate commercial uses including:
    - Pre-authorized drafts to pay a creditor or utilize a bill payment service
    - ACH administrative returns
    - Purchase item via telephone or internet
    - Depository transfer checks
    - Collect return check fees
  - Potential risks
    - Abuse and fraud associated with RCCs;
      - Regulatory guidance issued for RCCs
    - Banks and customers must manage risk (Know your customer)
- Substitute Check: Negotiable instrument created by the Check 21 Act
  - A properly prepared substitute check is the legal equivalent of the original item for all purposes
  - See part “F. Regulatory Environment, 2. Regulation CC” in this Section Two for more detail on the substitute check
- Teller’s Check - Drawn by a bank on another bank
  - Includes checks payable at or through a bank
    - Also checks drawn on a nonbank, as long as check is payable through or at a bank
  - Common uses include checks provided to customer for account disbursement or interest payments; checks acquired by non-customer for remittance purposes such as certain loan disbursement checks
SECTION TWO – TRAINING GUIDE

- Noncash items: Generally, not eligible for image exchange
  - Defined by Reg CC [229.2(u)] as:
    o Item that would otherwise be a check, except that a passbook, certificate or other document is attached;
      ▪ Is accompanied by special instructions such as a request for special advice of payment or dishonor;
      ▪ Consists of more than a single thickness of paper
        ✓ Except a check that qualifies for handling by automated check processing equipment
      ▪ Has not been preprinted or post-encoded in magnetic ink with the routing number of the paying bank
    ▪ Is a Foreign item

3. Remote Deposit Capture (RDC) [Source: RemoteDepositCapture.com]

- Overview/Purpose: Remote Deposit Capture (RDC) is the process of scanning and transmitting checks to a service provider/financial institution in order to electronically capture the deposit for clearing and posting. RDC may be referred to as:
  - Corporate capture
  - Merchant capture
  - Image deposit
  - Mobile deposit

- RDC electronifies the deposit process by truncating the paper item as early as possible in the collection process – at the customer/payee. It can provide benefits for corporate customers, merchants, consumers, and financial institutions alike. Examples of benefits for corporate customers and merchants would include:
  - Accelerated clearings and better deposit availability
  - Convenience and reduced transportation time/costs
  - Enhanced cash flow
  - Reduced return item risk
  - Processing efficiencies
  - Potential for consolidating banking relationships

- Examples of benefits for financial institutions would include:
  - Reduced transportations costs
  - Opportunities to expand customer footprint and increase/consolidate existing customers’ business
  - Ability to offer new products
  - Increased processing efficiencies

- Basic requirements for a customer to utilize RDC include a PC, an internet connection, a check scanner and a service provider/depository bank

- Basic process would be as follows:
  - Company, merchant or customer receives checks.
  - Company or merchant performs normal receipt/remittance process.
  - Company, merchant, or customer scans the deposit ticket and checks using a desktop scanner.
Once the check images are captured, an image-based deposit (or ACH file) is prepared. 
RDC system can then transmit an encrypted file to deposit the item(s) with the depositary bank. 
Bank receives the file, posts to company, merchant, or customer’s account and assigns availability based upon an agreed upon availability schedule. 
For transit items, depositary bank prepares and sends image cash letter to correspondent or paying bank as required.

- Figure 2.23 illustrates a basic remote deposit capture and transmission process from a merchant location to the Bank of First Deposit (BOFD)

Figure 2.23 Remote Deposit Capture and Transmission Process

- Potential Risks:
  - While RDC provides benefits for customers and financial institutions, it also introduces new risks. The largest risk is the potential for presenting duplicate items when the original check (that was scanned for RDC) is subsequently deposited or cashed.
  - Warranties that protect against duplicates are included in:
    - ECCHO Operating Rules
    - Regulation CC
    - Federal Reserve Operating Circular 3 (OC3) and
    - Regulation J
  - To mitigate risk, financial institutions should have specific RDC customer agreements following the latest FFIEC guidance.
    - See part “I. Fraud and Risk” in this guide and the FFIEC guidance on Remote Deposit Capture for additional details on RDC agreements.
Remote deposit capture agreements allow banks to pass back risks to the customer that are outside of the financial institution’s control.

Other procedures and policies should include:
- Follow “Know Your Customer” guidelines
- Establish teller procedures to examine checks for:
  - Stale dates
  - Stamps or other information to indicate an item was previously “franked” or indorsed for deposit
- Utilize technology for duplicate detection to diminish risk

4. Check Conversion

- ACH Check Conversion offers includes products that a bank can offer their customers; if check is eligible, may be converted to one of the following ACH SEC codes:
  - ARC – Accounts Receivable Entry
  - POP – Point-of-Purchase Entry
  - BOC – Back Office Conversion Entry
- See Exhibit 4 “ACH Check Conversion and Selected SEC Codes Overview” for more complete description of these Standard Entry Class (SEC) codes and specific requirements for each.

5. Cash Management Products: Examples may include:

- Reporting:
  - Balance Reporting – Secure, internet-based reporting of account and transaction information at a customer’s lead bank
    - For example, may include balances in foreign currencies, balances at other banks, information on cash positions and float, or investments
  - Zero Balance Accounting – Designed for customers who fund decentralized accounts from a central main account
    - As debits are charged to ZBAs, funds automatically transfer from the master account to cover the debit and bring the sub-account balance to zero
    - May also be referred to as “sweep accounts”

- Receivable Processing:
  - Lockbox: Cash management service offered by banks to customers to expedite receivables processing
    - Bank sets up a post office box, opens mail, and deposits checks received on behalf of customers
      - Retail Lockbox – Companies, such as utilities, that receive a high volume of payments via checks in the mail
        - May include a check and a remit advice/stub which can be processed/captured in an automated process
      - Wholesale Lockbox - Companies with small numbers of payments, sometimes with detailed requirements for processing, such as a doctor’s or dentist’s office
        - Supports non-standard forms
Disbursements:
- ACH Disbursements
  o Scheduling recurring payments through ACH system for such payments as dividends, interest, pensions, or direct payroll deposit

Account Reconciliation Products (ARP)
- Product dates to time when banks first offered customer bank statement reconciliation
  o Initially banks offered fully reconciled statement of checks paid and deposits made
- ARP services are offered for multiple accounts on a schedule
  o Typically defined by the customer – May be daily, weekly, monthly
- Goal of product: Increase amount of information and decrease amount of work in company’s accounting
- ARP services provide a wide range of reporting and access to reports through automated means; Many banks offer a range of reconciliation products including:
  - Full Reconciliation:
    o Customer provides the banks the data on the checks issued
    o Bank matches that data against the checks that cleared their account
    o Customer receives reconciliation reports including checks paid, outstanding items and exceptions
  - Partial Reconciliation
    o Customer receives a report of the items paid sorted usually by the customer’s instructions
  - Deposit Reconciliation
    o Allows customer to maintain one account but have deposits from multiple business locations
  - Positive Pay services: Can be very useful as fraud deterrents; includes:
    o Positive Pay: Service where the bank automatically matches each check presented against amount and check number on listing of checks issued
    o Payee Positive Pay: Service that matches the payee name from the issue file to the payee name on the check
      • Benefits: Bank reviews and flags checks that may be fraudulent (not on the listing of checks issued) and alerts the customer for decision to pay/not pay
    o Reverse Positive Pay: Service where bank sends information on checks to be posted to the customer and the customer compares each amount and check number to its listing of checks issued
      • Benefits: Customer can monitor and review checks and tell the bank whether to pay or reject any checks; some products may allow customer to adjust/correct check amount if value was misread
  - Controlled Disbursement: Daily report provided early in the day to the customer detailing the amount of disbursements that will be charged to the account that day
    o Corporations disburse funds from various operating accounts to settle trade payment, payrolls, dividends and other disbursements
SECTION TWO – TRAINING GUIDE

- Takes time for checks to be sent through the mail, processed, deposited and cleared through the banking system
- Lag of days between the initiation of a payment and the actual debit to the customer’s bank account, also known as float
- There are various types of float (i.e. mail float, clearing float, etc.)
- Due to the float, this product allows customers to fund their account only when the check posts, rather than when the check is written
- Early notification of the day’s funding requirement eliminates idle balances
- Customers can invest surplus funds or obtain additional funds, if needed
  - Money markets are active and investment rates attractive in the morning; short term investment rates generally move downward late in the morning
- Over the years, numerous changes to the payment system and its regulations have impacted Controlled Disbursement and some of these include:
  - Monetary Control Act of 1980 required the Fed to reduce or charge for float
  - RCPC – Regional Check Processing Centers
  - Federal Reserve High Dollar Group Sort (HDGS)
  - Same Day settlement
  - Day Light Overdraft pricing
  - ECP and MICR line presentment
  - Improvement in Check Transportation in the early days, now Check Transportation is mostly disbanded
  - Fed office closings
  - Image Exchange
- With the increased speed of clearing checks, customers typically buy Controlled Disbursement services now for the “control” of knowing the amount to fund on each day
- Benefits of Controlled Disbursement include:
  - Timely notification of daily funds needed
  - Reporting of funds that are transferred
  - Reduction of idle balances
  - Increased interest income from short term borrowing
  - Reduced borrowing costs

6. Review Questions

- The following questions are a review of key points covered in this section and may be used to further aid in the study of these topics. See “Section Four – Exhibits” - Exhibit 10 for the Answer Key.
  - What is the commonly used definition of an image cash letter?
  - Name three types of checks.
  - What is positive pay and why is it used?
  - What is controlled disbursement and why is it used?
  - Define three ACH check conversion products.
  - Define three cash management products and state the benefits for each.
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<td>SECTION TWO – TRAINING GUIDE</td>
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A. STUDYING FOR THE EXAM

Learning Objective: This section provides some general tips on how to prepare and study for the NCP certification exam. Please review all resources available as you plan your approach to study.

1. Plan now – Allow enough time to prepare
   - Set aside dedicated study time
     - Post-exam surveys consistently show that regularly making time for study can produce better results

2. Review the NCP Roadmap – Your Roadmap to Success
   - Provides suggestions on how to prepare and study for the exam
   - Steps the individual through a process to:
     - Discover the four (4) areas covered by the exam
     - Assess your knowledge and available time to determine how you will to prepare - self-study versus an exam prep training class
     - Begin your study for the exam
   - Reviews the various study tools:
     - Exam blueprint topics
     - Rules and Regulations overview
     - Operations overview
     - Fraud and Risk overview
     - Regulation CC overview
     - UCC Article 3 and Article 4 overview
     - Federal Reserve Operating Circular 3 (OC 3) overview
   - Note: NCP Roadmap is an overview and general approach to study. It is up to the individual to ultimately determine the best approach to study and prepare

3. Read through this entire P.R.E.P. Guide
   - Mark sections and topics that are unfamiliar or confusing for additional research and study
   - Complete all section Review Questions found throughout this Guide
     - Answer Key for all Review Questions provided in Exhibit 10
       - Allow time to further research and study for any missed questions

4. Test your knowledge with the Sample Exam
   - Multiple-choice questions included in this Guide (see Exhibit 14)
   - Intended to familiarize registrants with the style and format of a standard multiple-choice exam - similar to the NCP exam experience
     - Each question is presented with 4 possible multiple-choice answers
     - Exam questions reflect topics covered by the NCP examination but are not the same questions as found on the annual exam
SECTION THREE – STUDY TIPS

- Review this Guide first then attempt to answer each question
  - Sample Examination Answer Key included in Exhibit 14
- Mark any questions missed for review and further study

5. Review the NCP Exam Blueprint (see Exhibit 1)

6. Sign up and request an NCP Guide

- NCP Exam Registrants can choose a Guide to assist in exam preparation (Guides are paired based on availability)
- Guides serve as resources to improve the NCP journey
- Guides typically spend 1 – 5 hours during the candidate’s overall exam preparation answering questions about:
  - How and what to study
  - General check subject matter, and
  - Exam experience
- Guides can discuss blueprint areas and how to best allocate study time
  - Note: Guides do not take the place of an exam preparation training course or self-study for the NCP Exam (Guides are not teachers)
  - Guide can be asked questions to provide direction, but he/she is not responsible for training on subject matter
- Go to website for more information: www.eccho.org/ncp_guide

7. Review the “Question of the Day” emails

- Emails are sent each business day starting in January
- Sent to each candidate that completes the ECCHO/NCP Exam registration process
- Emails are sent from the program mailbox: “NCP Connection” (ncpc@eccho.org)
  - Each day a question is emailed then the following day the answer is provided for that question along with a new question
    - Answers may also contain additional information for further study
- Questions can be used to prompt good study habits and cover all exam categories
  - Create flash cards from the daily questions
- NCP Question of the Day emails are intended to help familiarize candidate with the reference materials used to create the exam as well as important topics influencing the check industry
  - Questions are strictly designed as a study aid
    - Note: these will not contain exact questions found on the NCP Exam
- Not getting the Question-of-the-Day emails?
  - Contact ECCHO at 214-273-3218 for assistance or email: ncpc@eccho.org
SECTION THREE – STUDY TIPS

8. **Consider supplemental training resources**
   - Consider online testing tools and flashcards
   - See list included on ECCHO website at: [www.eccho.org/partner_resources](http://www.eccho.org/partner_resources)

9. **Plan to take an Exam Training review class**
   - Training is offered by ECCHO’s NCP Educational Partners
   - ECCHO provides NCP Core Training Curriculum to NCP Partners for use in their exam prep training classes
     - Updated annually to reflect industry changes and to support new exam questions
     - See Figure 3.1 for list of recommended training session topics and descriptions
   - For a complete list of Educational Partners and links to available training offerings go to: [www.eccho.org/ncpc_training](http://www.eccho.org/ncpc_training)

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**Figure 3.1 NCP Training Review – 2019 Recommended Sessions & Descriptions**

<table>
<thead>
<tr>
<th>Session Topic</th>
<th>Description</th>
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<tbody>
<tr>
<td>Check Payments – The Basics</td>
<td>This entry level session provides a brief review of the check starting with the UCC definition of a negotiable instrument, defining the parts of a check, the parties to a check transaction, and ending with a check processing overview. The session includes an updated “Is this a Check” teaser. <em>(Note: Session has been pre-recorded and will be available to all NCP exam candidates upon registration with ECCHO)</em></td>
</tr>
<tr>
<td>Check Payments and Check Processing</td>
<td>Do you know the check? Get started with the key definitions, parts of a check, parties to the check, parts of the MICR line and the routing number as discussed in this session. Also included is a payments system overview including a brief discussion of presentment, settlement and float.</td>
</tr>
<tr>
<td>Regulations - Uniform Commercial Code</td>
<td>Review of the check payment system regulatory foundation begins with the Uniform Commercial Code. This session will cover UCC Articles 3 and 4 and will provide some scenarios illustrating key provisions.</td>
</tr>
<tr>
<td>Regulations - Reg CC–Part I</td>
<td>Regulation CC Part I and Part II address the final amendments to Reg CC (effective July 2018). Part I provides the regulatory foundation with a discussion of Regulation CC as part of the Code of Federal Regulations (CFR). It reviews the background of why Reg CC was amended and then covers the general provisions and definitions.</td>
</tr>
<tr>
<td>Regulations - Reg CC–Part II</td>
<td>Reg CC Part II introduces new definitions, new warranties and discusses the new RDC indemnity and the new ECI Indemnity. The discussion will include electronic check and electronic returned check within Reg CC and what that means to the image exchange process. Also discussed will be the continued requirement for rules and agreements for image exchange. Scenarios will be used for the trainee to apply their knowledge by illustrating key warranties and how breach of warranty situations may occur.</td>
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<tr>
<td>Session Topic</td>
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<tr>
<td>Standards and Formats</td>
<td>Are all those different X9 standards confusing? This session should help sort them out. From the X9.100-140 IRD standard, to the X9.100-160 MICR standard, to the X9.100-187 image cash letter standard, this session will walk you through the basics. The Universal Companion Document (UCD) TR 47 will also be discussed. The current Return Reason Code standard, X9.100-188 will be reviewed along with the brief overview of ECCHO’s Check Return Code Handbook.</td>
</tr>
<tr>
<td>Image Exchange: Rules and Agreements – ECCHO Rules</td>
<td>Part I – Image Exchange in the Private Sector: Why are rules and agreements needed for image exchange? This session will answer the question and review the rules for the predominant image exchange models. Part I will focus on the private sector image exchange channel and will focus on the ECCHO Operating Rules and Commentary as updated in July 2018 following the final amendments to Regulation CC.</td>
</tr>
<tr>
<td>Image Exchange: Rules and Agreements – Fed OC3</td>
<td>Part II – Image Exchange via the Federal Reserve: This session will again ask the question why are rules needed for image exchange? Part II focuses on the key provisions of image exchange through the Federal Reserve with a review of Operating Circular 3 (OC 3) and how Regulation J is referenced for the warranties. Both OC 3 and Regulation J conforming updates, following the final Reg CC amendments, are discussed. A brief comparison of the key similarities and differences between ECCHO Operating Rules and Federal Reserve’s OC 3 is included at the end of this session.</td>
</tr>
<tr>
<td>Image Exchange: Processes</td>
<td>The image cash letter (ICL) will be discussed in this session with a focus on how the ICL is built based on the image exchange standards. Scenarios will be used to show various processing examples to follow each step in how an image cash letter file is built and how the records are populated to move the image file through a forward or return process and in which operational situations you would need one record type versus another. Detailed examples and handouts will be provided. An overview of the “day in the life of a check” in an image environment will be included which will also cover operational activities from the point of view of the Depositary Bank and then from the viewpoint of the Paying Bank.</td>
</tr>
<tr>
<td>Exceptions - Returns and Adjustments</td>
<td>What happens when an item cannot be immediately processed and needs special handling? This session will focus on those exception situations with a focus on decisioning and how to decide item disposition. Should it be handled as a return or an adjustment and how does timing factor into this decision? If the item is sent as a return, what return codes should be included so the item can be properly identified by the depositary bank upon receipt? Common error and adjustment types as handled through both the Fed and private sector are covered in this session including the latest adjustment codes for the new RDC and ECI indemnity claims.</td>
</tr>
<tr>
<td>Check Products</td>
<td>Types of checks and check products including the image cash letter (ICL), remotely created checks (RCCs), ARP products including positive pay, controlled disbursement and lockbox are all covered in this session. A review of Remote Deposit Capture is included as well. A brief overview of the ACH check conversion SEC codes will be included.</td>
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## SECTION THREE – STUDY TIPS

<table>
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<tr>
<th>Session Topic</th>
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<tr>
<td>Fraud, Risk and Risk Mitigation</td>
<td>This session provides an overview of payments fraud with a discussion of types of fraud and ideas for identifying and potentially preventing those types of fraud. The session includes a discussion of the Federal Financial Institution Examination Council (FFIEC) guidance for financial institution examiners including specific guidance on risk management. The six main types of risk are covered including general strategies for managing each. A review of the guidance’s four main areas of focus for Business Continuity Planning are included. This session will wrap up with the latest FFIEC guidance for RDC risk management.</td>
</tr>
</tbody>
</table>
| 2019 Exam Prep Training Review(s)     | Recommend training series review(s) covering key points of the entire training program. It is recommended these be delivered throughout the training. Timing may be determined by training partner. Suggestions:  
  • At the halfway point in each series  
  • At the conclusion of the series  
  • Final overall review and/or exam to highlight key points |
SECTION THREE – STUDY TIPS

COMMENTS/NOTES
SECTION THREE – STUDY TIPS
SECTION FOUR – EXHIBITS

EXHIBIT 1: EXAM TOPICS: THE NCP EXAMINATION BLUEPRINT

The outline of NCP exam topics below shows the updated NCP Exam categories and associated knowledge subject areas (KSAs) for the upcoming exam year. Exam questions are written based on these KSA topics which are uniquely identified within each of the four main categories:

- Category 1: Rules, Laws, and Regulations
- Category 2: Fraud and Risk Mitigation
- Category 3: Operations
- Category 4: Products

Percentages shown in each category correspond to the number of questions in that category that contribute to the total of 100 items scored on the exam. For example, Rules, Laws and Regulations make up 34% of the exam and would account for 34 of 100 exam points while the Products category makes up 8% of the exam and would account for 8 of 100 exam points.

1. Rules, Laws, and Regulations (34%)
   Demonstrate a comprehensive knowledge of the following topics as they relate to check with respect to Electronic Check Clearing House Organization (ECCHO) Rules, Uniform Commercial Code (UCC) Articles 3 and 4, Regulation CC, Regulation J, and Federal Reserve Operating Circular 3 (OC3) and selected sections of NACHA Rules and Regulation E.
   1.01 Key terms defined in the rules, laws, and regulations
   1.02 Eligible items
   1.03 MICR line repair
   1.04 Warranties
   1.05 Indemnification
   1.06 Error resolution, including adjustments
   1.07 Imperfect/Nonimageable Item
   1.08 Indorsements
   1.09 Presentment
   1.10 Re-presentment
   1.11 Returns
   1.12 Disclosures
   1.13 Funds availability
   1.14 Bank settlement & finality

2. Fraud and Risk Mitigation (25%)
   Demonstrate knowledge required to identify fraud and mitigate risk associated with check products and services and to comply with the regulatory requirements, including the Uniform Commercial Code (UCC) Articles 3 and 4, Bank Secrecy Act/Anti-Money Laundering (BSA/AML), and Federal Financial Institution Examination Council (FFIEC) guidance. This includes these aspects:
   2.20 Key provisions of laws, regulations, and guidance
SECTION FOUR – EXHIBITS

2.21 Definitions of types of fraud and risk (kiting, alterations, forged indorsement, counterfeit, forged drawer signature, intentional duplicates, theft, stale or postdated checks)
2.22 Allocation of risk
2.23 Consumer, bank, and commercial agreements
2.24 Unique risks associated with remote deposit capture and remotely created checks
2.25 Risk mitigation techniques (e.g., positive pay, security features)
2.26 Data security and data breach
2.27 Business continuity/disaster recovery

3. Operations (33%)
Demonstrate a comprehensive understanding of all aspects of check operations. In addition, demonstrate awareness of key standards such as ANSI and ACH formats.

3.30 Item processing
   - Point of capture (customer, branch, lockbox, ATM, other bank, third-party processor)
   - Item Capture (paper and electronic)
   - Quality control
   - Proofing and balancing transactions
   - Clearing, including Automated Clearing House (ACH) conversion
   - Posting
   - Reconcilement
   - Bank settlement

3.31 File control
   - Rejected items and files
   - Transmission and acknowledgement

3.32 Exception handling
   - Exception dispositioning
   - Research
   - Returns
   - Adjustments

3.33 Retention, retrieval, and destruction

3.34 Account statements

3.35 Application of Automated Clearing House (ACH) file format for check conversion

3.36 Application of ANSI Standards
   - IRD format (X9.100-140)
   - MICR line (X9.100-160, Parts 1 and 2)
   - Image File Format (X9.100-187 and the UCD - TR 47)
   - Return Reasons for Check-Image Exchange (X9.100-188-2016)

4. Products (8%)
Demonstrate a basic knowledge of the types, benefits, and purpose of correspondent banking products and customer (commercial and consumer) products, including the following topics:

4.40 Types of checks (remotely created checks, money orders, substitute checks, official checks, treasury, government checks, warrants)

4.41 Global checks (US dollar foreign checks, non-US denomination checks)
SECTION FOUR – EXHIBITS

4.42 Check conversion (ARC, POP, BOC, RCK) and replacement (WEB, TEL)
4.43 Corporate and correspondent cash management products
   - Account reconciliation products
   - Positive pay
   - Controlled disbursement
   - Lock box
   - Image cash letter
   - Remote deposit capture
   - Float
4.44 Consumer check services
   - Statementing
   - Image retrieval
   - Remote deposit capture
   - Online and mobile banking
SECTION FOUR – EXHIBITS

EXHIBIT 2: NCP EXAMINATION – REFERENCE MATERIALS

In addition to Exam Prep training, links to the following reference materials may be found on the NCP Training page on the ECCHO website at: www.eccho.org/ncpc_training

Each reference document cited during the development of the exam questions has been reviewed and listed here. These documents and other related materials are also recommended as additional reading and study resources throughout this document.

Specific information from a number of these documents needed to study effectively for the exam has been included in this guide.

- Check Clearing for the 21st Century (Check 21 Act)
- ECCHO Operating Rules and Commentary
- Federal Reserve Check Adjustments Quick Reference Guide
- Federal Reserve Operating Circular 3 Oct-2018
- Federal Financial Institution Examination Council (FFIEC) References:
  - Authentication in an Internet Banking Environment October 2005
  - Supplement to Authentication in an Internet Banking Environment June 2011
  - Bank Secrecy Act/Anti-Money Laundering Examination Manual-2010
  - Information Security Sep 2016
  - Operations July 2004
  - Retail Payment Systems April 2016
  - Supervisory Guidance for Remote Deposit Capture 1/14/2009
- FinCEN Advisory–FIN-2012-A010 10/22/12; 2016-A005
- Regulation CC (Reg CC) - Availability of Funds and Collection of Check
- Regulation E (Reg E) - Electronic Fund Transfers
- Regulation J (Reg J) - Collection of Checks and Other Items by Federal Reserve
- Treasury Securities & Programs
- Uniform Commercial Code (UCC) Article 3
- Uniform Commercial Code (UCC) Article 4

In addition, the following ANSI Standards for Financial Services and selected technical reports are referenced:

- Image Replacement Document - IRD (X9.100-140)
- Magnetic Ink Printing (MICR) Part 1: Placement and Location (X9.100-160-1)
- Magnetic Ink Printing (MICR) Part 2: EPC Field Use (X9.100-160-2)
- Electronic Exchange of Check and Image Data (X9.100-187)
- Return Reasons for Check Image Exchange and IRDs (X9.100-188)
- Understanding, Designing and Producing Checks (TR 2)
- Universal Companion Document Industry Adoption of X9.100-187 (TR 47)
ECCHO offers the NCP exam through the nationwide network of PSI proctored test locations. The PSI Exams Online website opens for registration for each annual exam approximately three weeks before the testing window opens. The exam window currently begins on a Saturday – the 3rd full weekend in April and runs for three weeks.

An exam registrant must complete the PSI registration process, including the selection of a testing date and location to be eligible to sit for the NCP exam. To find a testing center, visit the PSI website at: www.psiexams.com

- Select “Certification/Professional Associations” from the options and then you may select the sponsor (ECCHO)
  - Sponsor name is listed as “Electronic Check Clearing House Organization” in the drop-down list provided
    - National Check Payments Certification exam will be shown
    - Click on the exam name for access to Candidate Information Bulletin or to access list of Test Center

- For test center locations – go to the Testing Information section on the PSI website and:
  - Select the “Testing Centers” option
  - Select your state from the drop-down menu
  - View closest Testing Centers based on the state entered

- For assistance or for more exam information, contact ECCHO or visit the website at: www.eccho.org/ncpc
## EXHIBIT 4: ACH CHECK CONVERSION AND SELECTED SEC CODES OVERVIEW

<table>
<thead>
<tr>
<th>SEC Code</th>
<th>ARC Accounts Receivable Entry</th>
<th>POP Point-of-Purchase Entry</th>
<th>BOC Back Office Conversion Entry</th>
<th>RCK Re-presented Check Entry</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Description of electronic check transaction (e-check)</strong></td>
<td>Single entry debit initiated by an Originator to the account of a Receiver based on an Eligible Source Document (Check) via U.S. Mail, delivery service, drop-box location or in person at a manned location</td>
<td>Single entry debit initiated by an Originator to an account of a Receiver based on an Eligible Source Document (Check) taken at the point-of-purchase or manned bill payment location</td>
<td>Single entry debit initiated by an Originator to an account of a Receiver based on an Eligible Source Document (Check) received at the point-of-purchase or manned bill payment location for subsequent conversion during back-office processing</td>
<td>Single entry debit which provides businesses the ability to collect funds from consumer paper checks that have been processed through the check collection system and returned due to insufficient or uncollected funds</td>
</tr>
<tr>
<td><strong>Dollar Limit</strong></td>
<td>$25,000 or less</td>
<td>$25,000 or less</td>
<td>$25,000 or less</td>
<td>Less than $2,500</td>
</tr>
<tr>
<td><strong>Legal Framework</strong></td>
<td>NACHA Rules, EFTA Regulation E</td>
<td>NACHA Rules, EFTA Regulation E</td>
<td>NACHA Rules, EFTA Regulation E</td>
<td>NACHA Rules, EFTA Regulation E, UCC Regulation CC</td>
</tr>
<tr>
<td><strong>Authorization Requirements</strong></td>
<td>Authorization = Notice and receipt of the Receiver’s check Billers may place required notice on back of billing statement. If the payment is made in-person, the Originator must provide a copy of the notice to the Receiver</td>
<td>Authorization = Notice plus receipt of the Receiver’s check and signed authorization by the Receiver at time of purchase Notice must be posted in a prominent and conspicuous location, and a copy of the notice must be provided to the Receiver</td>
<td>Authorization = Notice plus receipt of the Receiver’s check Notice must be posted in a prominent and conspicuous location, and a copy of the notice must be provided to the Receiver</td>
<td>Notice must be provided to the Receiver in advance of receiving the check item to which the RCK relates.</td>
</tr>
<tr>
<td><strong>Can business checks be converted?</strong></td>
<td>Only business checks that do not contain an auxiliary-on-us field</td>
<td>Only business checks that do not contain an auxiliary-on-us field</td>
<td>Only business checks that do not contain an auxiliary-on-us field</td>
<td>No</td>
</tr>
</tbody>
</table>
### SECTION FOUR – EXHIBITS

#### Check Conversion Standard Entry Class (SEC) Codes

**Source:** NACHA, ECC, ACH Primer – Dec. 2007

<table>
<thead>
<tr>
<th>SEC Code</th>
<th>ARC Accounts Receivable Entry</th>
<th>POP Point-of-Purchase Entry</th>
<th>BOC Back Office Conversion Entry</th>
<th>RCK Re-presented Check Entry</th>
</tr>
</thead>
<tbody>
<tr>
<td>What is required to print on the consumer’s statement?</td>
<td>Company Entry Description, Company name and Check Serial Number</td>
<td>Check Serial Number, Terminal City/State, address, telephone number to be used for inquiries or notices of errors preceded by ‘Direct Inquires To” or similar language</td>
<td>Company Entry Description, Company name and Check Serial Number</td>
<td>REDEPCHECK – Company Entry Description, Company name and Check Serial Number</td>
</tr>
<tr>
<td>Check / Authorization retention requirements</td>
<td>Originator will retain a reproducible and legible copy of the front of the source document utilized to create and ARC entry for two (2) years from the Settlement Date. An Originator will establish and implement commercially reasonable methods to securely store the source document until securely destroyed</td>
<td>Determined by Receiver as they receive the voided check and a receipt for their purchase.</td>
<td>Originator will retain a reproducible and legible copy of the front of the source document utilized to create and ARC entry for two (2) years from the Settlement Date. An Originator will establish and implement commercially reasonable methods to securely store the source document until securely destroyed</td>
<td>Originator must be able to provide a copy of front and back of item related to the RCK entry for seven (7) years. Not required to retain original check</td>
</tr>
<tr>
<td>Timing for Receiver to dispute transaction?</td>
<td>60 calendar days right of return from posting date Reg E error resolution applies</td>
<td>60 calendar days right of return from posting date Reg E error resolution applies</td>
<td>60 calendar days right of return from posting date Reg E error resolution applies</td>
<td>60 calendar days right of return from posting date Reg E error resolution does not apply</td>
</tr>
</tbody>
</table>
SECTION FOUR – EXHIBITS

EXHIBIT 5: FORWARD EXCHANGE WARRANTIES

<table>
<thead>
<tr>
<th>Source /Type</th>
<th>Warranty or Other Responsibility</th>
<th>Application to Banks and/or Customers</th>
</tr>
</thead>
</table>
| Reg CC – Transfer Warranties for Settlement Amount and Encoding §229.34(c)(2) and (c)(3) | Bank that transfers a check warrants:  
  (1) To the transferee bank, that the accompanying information, if any, accurately indicates total amount of checks transferred; and  
  (2) To any bank that subsequently handles the check, that, at the time of transfer, the information encoded on check after issue is accurate. | Applies interbank only                 |
| Reg CC – Presentment Warranties for Settlement Amount and Encoding §229.34(c)(1) and (c)(3) | Bank that presents a check warrants:  
  (1) To the paying bank, that the total amount presented equals total amount requested for settlement; and  
  (2) To any bank that subsequently handles the check, that, at the time of presentment, the information encoded on check after issue is accurate. | Applies interbank only                 |
| Reg CC – Transfer and Presentment Warranty for Remotely Created Checks (RCCs) §229.34(b) | Bank that transfers or presents a remotely created check and receives settlement or other consideration warrants to the transferee bank, any subsequent collecting bank and the paying bank that the remotely created check is authorized in the amount and to the payee stated on the check. | Applies interbank only                 |

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<tr>
<th>Source / Type</th>
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<th>Application to Banks and/or Customers</th>
</tr>
</thead>
</table>
| Reg CC – Transfer Warranties for Electronic Checks    | Bank that transfers or presents an electronic check or electronic returned check and receives a settlement or other consideration for it warrants that:  
(i) The electronic image accurately represents all of the information on the front and back of the original check as of the time that the original check was truncated, and the electronic information includes an accurate record of all MICR line information required for a substitute check under § 229.2(aaa) of Regulation CC and the amount of the check, and  
(ii) No person will receive a transfer, presentment, or return of, or otherwise be charged for an electronic check or electronic returned check, the original check, a substitute check, or a paper or electronic representation of a substitute check such that the person will be asked to make payment based on a check it has already paid. | Applies interbank  
Warranties also flow to the drawer customer (on forward exchange) and the owner of check (on return exchange).                                                                                                                                                                                                                                                                                                                                                                                                     |
| Reg CC – Substitute Check Warranties                  | Bank that transfers, presents, or returns a substitute check (or a paper or electronic representation of a substitute check) for which it receives consideration warrants that:  
(1) Substitute check meets requirements for legal equivalence [§ 229.51(a)(1)-(2) of Regulation CC]; and  
(2) No duplicate payment.                                                                                                                                                                                                                                                                                                                                                                                                                               | Applies interbank and to any other person that receives a substitute check or electronic check created from a substitute check.                                                                                                                                                                                                                                                                                                                                                     |
## SECTION FOUR – EXHIBITS

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</tr>
</thead>
<tbody>
<tr>
<td><strong>UCC Transfer Warranties</strong> § 4-207(a)</td>
<td>Person or collecting bank that transfers an item warrants to the transferee and any subsequent collecting bank: (1) Warrantor is entitled to enforce the item; (2) All signatures on the item are authentic and authorized; (3) Item has not been altered; (4) Item is not subject to defense or claim or recoupment; (5) Warrantor has no knowledge of any insolvency proceeding commenced with respect to maker or acceptor; and (6) With respect to RCC consumer item, person on whose account item is drawn authorized item and the amount for which it is drawn.</td>
<td>Applies interbank only Made applicable to the electronic check exchange process by means of ECCHO Rules and Reg J, as applicable.</td>
</tr>
<tr>
<td><strong>UCC Presentment Warranties</strong> § 4-208(a)</td>
<td>Person presenting item and previous transferor warrant to the drawee bank: (1) Warrantor is entitled to enforce draft or authorized to obtain payment or acceptance of the draft on behalf of a person entitled to enforce the draft; (2) Item has not been altered; and (3) Warrantor has no knowledge that signature of the purported drawer of the draft is unauthorized; and (4) With respect to RCC consumer item, person on whose account item is drawn authorized item and the amount for which it is drawn.</td>
<td>Applies interbank only Made applicable to the electronic check exchange process by means of ECCHO Rules and Reg J, as applicable.</td>
</tr>
<tr>
<td><strong>UCC Encoding Warranty</strong> § 4-209(a)</td>
<td>Person encoding information on item after issue warrants that the information is correctly encoded. If the customer of a depositary bank encodes, bank also makes the warranty.</td>
<td>Applies interbank and to payor customer See also ECCHO indemnity protection for repairing/encoding bank</td>
</tr>
</tbody>
</table>
## SECTION FOUR – EXHIBITS

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<tbody>
<tr>
<td><strong>ECCHO Operating Rules</strong>&lt;br&gt;Repair of Item&lt;br&gt;§ III(C)(1) and § III(C)(2)(a)</td>
<td>Sending Bank warrants correct repair of RT and amount fields. &lt;br&gt;Damages for breach of this warranty shall not exceed amount of item plus interest compensation and expenses, if any.</td>
<td>Applies to ECCHO members only</td>
</tr>
<tr>
<td><strong>ECCHO Operating Rules</strong>&lt;br&gt;Sending Bank Warranty of Compliance with ECCHO Rules&lt;br&gt;§ XIX(L)</td>
<td>Sending Bank warrants to Receiving Bank, with respect to each Electronic Check sent, that the Sending Bank complied with ECCHO Rules.</td>
<td>Applies interbank to ECCHO members only</td>
</tr>
<tr>
<td><strong>ECCHO Operating Rules</strong>&lt;br&gt;Receiving Bank Warranty of Compliance with ECCHO Rules&lt;br&gt;§ XIX(M)</td>
<td>Receiving Bank warrants to Sending Bank, with respect to each Electronic Check received, that the Receiving Bank complied with ECCHO Rules.</td>
<td>Applies interbank to ECCHO members only</td>
</tr>
<tr>
<td><strong>ECCHO Operating Rules</strong>&lt;br&gt;Forged and Counterfeit Check Warranties&lt;br&gt;§ XIX(O)(2)</td>
<td>Sending Bank that is also Depositary Bank and any subsequent Sending Bank warrants: &lt;br&gt;(a) Signature of the purported drawer of Related Physical Check is not forged or otherwise unauthorized, and/or &lt;br&gt;(b) The Related Physical Check is not counterfeit.</td>
<td>Applies interbank to ECCHO members only</td>
</tr>
<tr>
<td>Source /Type</td>
<td>Warranty or Other Responsibility</td>
<td>Application to Banks and/or Customers</td>
</tr>
<tr>
<td>--------------</td>
<td>---------------------------------</td>
<td>--------------------------------------</td>
</tr>
<tr>
<td>Federal Reserve – Regulation J § 210.5(a)(2)</td>
<td><strong>Sender Warrants to each Reserve Bank handling the item that:</strong>&lt;br&gt; (i) The sender is a person entitled to enforce the item or authorized payment of the item on behalf of a person entitled to enforce the item;&lt;br&gt; (ii) The item has not been altered; and&lt;br&gt; (iii) The item bears all indorsements applied by parties that previously handled the item, in paper or electronic form, for forward collection or return</td>
<td>Applies interbank only&lt;br&gt;Applies to Items Exchanged through Federal Reserve</td>
</tr>
<tr>
<td>Federal Reserve – Regulation J § 210.5(a)(3)</td>
<td><strong>Warranties for All Electronic Items:</strong>&lt;br&gt;Sender makes all the warranties set forth in and subject to the terms of 4-207 of the UCC for an electronic item as if it were an item subject to the UCC; and&lt;br&gt;Makes the warranties set forth in and subject to the terms of 12 CFR § 229.34(c) for an electronic item as if it were a check subject to that section</td>
<td>Applies interbank only&lt;br&gt;Applies to Items Exchanged through Federal Reserve</td>
</tr>
<tr>
<td>Federal Reserve – Regulation J § 210.5(a)(4)</td>
<td><strong>Warranties for Electronic Items that are not representations of Substitute Checks</strong>&lt;br&gt;If the item is an electronic item that is not a representation of a substitute check, Sender warrants to each Reserve Bank handling the item that:&lt;br&gt; (i) Electronic image portion of item accurately represents all of the information on the front and back of original check at time original check was truncated; the information portion of the item contains a record of all MICR line information required for substitute checks under Reg CC; item meets technical requirements to send electronic items to Reserve Bank as set forth in operating circular;&lt;br&gt; (ii) No person will receive transfer, presentment, or return of, or otherwise be charged for, the electronic item, original item, or paper or electronic representation of electronic item such that person will be asked to make payment based on item it already has paid. (no double debit)</td>
<td>Applies interbank only&lt;br&gt;Applies to Items Exchanged through Federal Reserve</td>
</tr>
</tbody>
</table>
## SECTION FOUR – EXHIBITS

<table>
<thead>
<tr>
<th>Source /Type</th>
<th>Warranty or Other Responsibility</th>
<th>Application to Banks and/or Customers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal Reserve – Regulation J § 210.6(b)(1)</td>
<td>Reserve Bank warrants to subsequent collecting bank and the paying bank any other payor that: (i) The Reserve Bank is a person entitled to enforce the item or authorized payment of the item on behalf of a person entitled to enforce the item; (ii) The item has not been altered; and (iii) The item bears all indorsements applied by parties that previously item, in paper or electronic form, for forward collection or return.</td>
<td>Applies interbank only Applies to Items Exchanged through Federal Reserve</td>
</tr>
<tr>
<td>Federal Reserve – Regulation J § 210.6(b)(2)</td>
<td>Warranties for All Electronic Items: Reserve Bank makes all the warranties set forth in and subject to the terms of 4-207 of the UCC for an electronic item as if it were an item subject to the UCC; and Makes the warranties set forth in and subject to the terms of 12 CFR § 229.34(c) for an electronic item as if it were a check subject to that section</td>
<td>Applies interbank only Applies to Items Exchanged through Federal Reserve</td>
</tr>
<tr>
<td>Federal Reserve – Regulation J § 210.6(b)(3)</td>
<td>Warranties for Electronic Items that are not representations of Substitute Checks: If the electronic item that is not a representation of a substitute check, the Reserve Bank warrants to the bank to which it transfers or presents that item that: (i) The electronic image portion of the item accurately represents all of the information on the front and back of the original check as of the time that the original check was truncated; the information portion of the item contains a record of all MICR line information required for substitute checks under Reg. CC; the item meets the technical requirements for sending electronic items to a Reserve Bank as set forth in the operating circular; (ii) No person will receive a transfer, presentment, or return of, or otherwise be charged for, the electronic item, the original item, or a paper or electronic representation of the electronic item such that the person will be asked to make payment based on an item it already has paid (no double debit)</td>
<td>Applies interbank only Applies to Items Exchanged through Federal Reserve</td>
</tr>
</tbody>
</table>
### EXHIBIT 6: FORWARD EXCHANGE INDEMNIFICATION OR OTHER LIABILITY

<table>
<thead>
<tr>
<th>Source /Type</th>
<th>Indemnity or Other Liability or Responsibility</th>
<th>Application to Banks and/or Customers</th>
</tr>
</thead>
</table>
| **Reg CC – Electronically Created Item (ECI) Indemnity** § 229.34(g) | Each bank that transfers or presents an ECI shall indemnify each transferee bank, any subsequent collecting bank, the paying bank, and any subsequent returning bank against losses that result from the fact that—  
(i) the electronic image or electronic information is not derived from a paper check;  
(ii) the person on whose account the ECI is drawn did not authorize the issuance of the item in the amount stated on the item or to the payee stated on the item; or  
(iii) A person receives a transfer, presentment, or return of, or otherwise is charged for an ECI such that the person is asked to make payment based on an item or check it has already paid. | Applies interbank only |
| **Reg CC – Remotely Deposited Check (RDC) Indemnity** § 229.34(f) | The RDC depositary bank indemnifies a depositary bank that accepts the original paper check for deposit for losses incurred by that depositary bank, if the loss is due to the check having already been paid.  
This indemnity applies if the RDC depositary bank accepts an RDC deposit, does not receive the original check, and does not receive a return of the electronic check unpaid. | This indemnity applies only between the RDC depositary bank and the depositary bank that accepts the original paper check for deposit.  
Note: This indemnity does not follow forward exchange path of the electronic check but instead is between the depositary banks. |

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<table>
<thead>
<tr>
<th>Source /Type</th>
<th>Indemnity or Other Liability or Responsibility</th>
<th>Application to Banks and/or Customers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reg CC - Check 21 Substitute Check indemnity § 229.53(a)</td>
<td>Bank that transfers, presents, or returns a substitute check or other representation of a substitute check for which it receives consideration indemnifies the recipient and any subsequent recipient for any loss incurred from receipt of substitute check if the loss occurred due to receipt of substitute check instead of original item.</td>
<td>Indemnity could arise for interbank exchange and between paying bank and its customer</td>
</tr>
<tr>
<td>ECCHO Operating Rules Sending Bank Indemnity for Breach of Warranty of Compliance with ECCHO Rules § XIX(L)</td>
<td>If Sending Bank breaches its warranty of compliance with the ECCHO Rules set forth in Section XIX(L), it indemnifies the Receiving Bank and holds the Receiving Bank harmless from and against any damage, expense or loss, including attorneys’ fees, suffered as a result of the breach.</td>
<td>Applies interbank to ECCHO members only</td>
</tr>
<tr>
<td>ECCHO Operating Rules Receiving Bank Indemnity for Breach of Warranty of Compliance with ECCHO Rules § XIX(N)</td>
<td>If Receiving Bank breaches its warranty of compliance with the ECCHO Rules set forth in Section XIX(N), it indemnifies the Sending Bank and holds the Sending Bank harmless from and against any damage, expense or loss, including attorneys’ fees, suffered as a result of the breach.</td>
<td>Applies interbank to ECCHO members only</td>
</tr>
<tr>
<td>ECCHO Operating Rules Sending Bank Responsibility for Check 21 Liability incurred by Receiving Bank § XIX(Q)</td>
<td>If an electronic check exchanged under Rules is converted by Reconverting Bank into substitute check and Reconvert the Bank incurs liability under Check 21 Act or Subpart D (Substitute Checks) of Regulation CC as a result of an act or omission of Member, Reconvert the Bank has recourse to the Member or other bank to extent Reconvert Bank’s liability under Check 21 Act or Subpart D of Regulation CC resulted from act or omission of Member.</td>
<td>Applies to ECCHO members only</td>
</tr>
</tbody>
</table>
## SECTION FOUR – EXHIBITS

<table>
<thead>
<tr>
<th>Source / Type</th>
<th>Indemnity or Other Liability or Responsibility</th>
<th>Application to Banks and/or Customers</th>
</tr>
</thead>
</table>
| Federal Reserve – Regulation J § 210.5(a)(5)(i) | Sender indemnifies each Reserve Bank for any loss or expense sustained (including attorney fees and expenses of litigation) from:  
(A) The sender’s lack of authority to make the warranties;  
(B) Any action taken by the Reserve Bank within the scope of its authority in handling the item;  
(C) Any warranty or indemnity made by the Reserve Bank under Section 210.6(b) of Regulation J | Applies interbank only  
Appplies to Items Exchanged through Federal Reserve |
| Federal Reserve – Regulation J § 210.6(b)(3) | If the item is an electronic item that is not a representation of a substitute check:  
Reserve Bank agrees to indemnify the bank to which it transfers or presents the electronic item (the recipient bank) for the amount of any losses that the recipient bank incurs under Subpart D of Reg. CC for an indemnity that the recipient bank was required to make under Subpart D in connection with a substitute check later created from the electronic item  
Notwithstanding that above indemnity, the Reserve Bank shall not be liable for any amount that the recipient bank pays under subpart D of Reg. CC that is attributable to the lack of good faith or failure to exercise ordinary care of the recipient bank or a person that handled the item, in any form, after the recipient bank | Applies interbank only  
Appplies to Items Exchanged through Federal Reserve |
## SECTION FOUR – EXHIBITS

### EXHIBIT 7: RETURN WARRANTIES

<table>
<thead>
<tr>
<th>Source /Type</th>
<th>Return Warranty or Other Responsibility</th>
<th>Application to Banks and/or Customers</th>
</tr>
</thead>
</table>
| Reg CC – Transfer Warranties for Settlement Amount and Encoding §229.34(c)(2) and (c)(3) | Bank that transfers check to returning bank or the depositary bank warrants that:  
(i) Accompanying information accurately indicates total amount of checks transferred; and  
(ii) The information encoded on check after issue is accurate. | Applies interbank only |
| Reg CC - Returned Check Warranties § 229.34(d)(1) | Each paying bank or returning bank that transfers a returned check warrants to transferee returning bank, to any subsequent returning bank, depositary bank, and owner of the check, that:  
(1) Return is timely under UCC and Reg CC;  
(2) Bank is authorized to return the check;  
(3) Check has not been materially altered; and  
(4) In the case of a notice in lieu of return, the check has not and will not be returned. | Applies interbank and to owner of check |
| Reg CC- Warranty of notice of nonpayment § 229.34(e)(1) | Paying bank that gives a notice of nonpayment warrants to the subsequent transferee banks, the depositary bank and the owner of the check that:  
(i) Return is or will be timely under UCC and Reg CC;  
(ii) Bank is authorized to send notice; and  
(iii) The check has not been materially altered. | Applies interbank and to owner of check |

**Note:** These warranties are not made for checks drawn on US Treasury, USPS money orders, or check drawn on a state or a unit of general local government not payable through or at a bank

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<th>Return Warranty or Other Responsibility</th>
<th>Application to Banks and/or Customers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reg CC - Transfer Warranties for Electronic Returned Checks §229.34(a)(1) and (a)(2)</td>
<td>Each bank that transfers or presents an electronic check or electronic returned check and receives a settlement or other consideration for it warrants that: (i) The electronic image accurately represents all of the information on the front and back of the original check as of the time that the original check was truncated, and the electronic information includes an accurate record of all MICR line information required for a substitute check under § 229.2(aaa) of Regulation CC and the amount of the check, and (ii) No person will receive a transfer, presentment, or return of, or otherwise be charged for an electronic check or electronic returned check, the original check, a substitute check, or a paper or electronic representation of a substitute check such that the person will be asked to make payment based on a check it has already paid. <em>(Commonly referred to as “No Duplicate Payment” warranty)</em></td>
<td>Warranties also flow to the drawer customer (on forward exchange) and the owner of check (on return exchange)</td>
</tr>
<tr>
<td>Reg CC - Substitute Check Warranties § 229.52(a)</td>
<td>Bank that transfers, presents, or returns a substitute check (or a paper or electronic representation of a substitute check) for which it receives consideration warrants that: (1) Substitute check meets requirements for legal equivalence [§ 229.51(a)(1)-(2) of Regulation CC]; and (2) No duplicate payment.</td>
<td>Applies interbank and to any other person that receives a substitute check or electronic check created from a substitute check.</td>
</tr>
<tr>
<td>ECCHO Operating Rules Returning Member's Warranty of Compliance with ECCHO Rules § XX(J)</td>
<td>Each Returning Member warrants to the Returnee Member, with respect to each Electronic Returned Check sent by the Returning Bank to the Returnee Member, that the Returning Member complied with ECCHO Rules.</td>
<td>Applies interbank to ECCHO members only</td>
</tr>
</tbody>
</table>
### SECTION FOUR – EXHIBITS

<table>
<thead>
<tr>
<th>Source /Type</th>
<th>Return Warranty or Other Responsibility</th>
<th>Application to Banks and/or Customers</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ECCHO Operating Rules</strong>&lt;br&gt;Returnee Member’s Warranty of Compliance with ECCHO Rules&lt;br&gt;§ XX(K)</td>
<td>Each Returnee Member warrants to the Returning Member, with respect to each Electronic Returned Check received by the Returnee Member from the Returning Member, that the Returnee Member complied with ECCHO Rules.</td>
<td>Applies interbank to ECCHO members only</td>
</tr>
<tr>
<td><strong>Federal Reserve – Regulation J&lt;br&gt;§ 210.12(c)(2)</strong></td>
<td><strong>Warranties for all returned checks</strong>&lt;br&gt;Paying bank or returning bank warrants to each Reserve Bank handling returned check that returned check bears all indorsements applied by parties that previously handled returned check, in paper or electronic form, for forward collection or return</td>
<td>Applies interbank only</td>
</tr>
<tr>
<td><strong>Federal Reserve – Regulation J&lt;br&gt;§ 210.12(c)(3)</strong></td>
<td><strong>Warranties for all returned checks that are electronic items</strong>&lt;br&gt;Paying or returning bank that sends returned check that is electronic item make the returning bank warranties set forth in and subject to the terms of 12 C.F.R § 229.34(c) for an electronic item as if it were a check subject to that section</td>
<td>Applies interbank only</td>
</tr>
<tr>
<td><strong>Federal Reserve – Regulation J&lt;br&gt;§ 210.12(c)(4)</strong></td>
<td><strong>Warranties for Electronic Items that are not representations of Substitute Checks</strong>&lt;br&gt;If the returned item that is an electronic item that is not a representation of a substitute check, the paying bank warrants to each Reserve Bank handling the returned check that:&lt;br&gt;(i) The electronic image portion of item accurately represents all of the information on front and back of the original check as of the time that the original check was truncated; the information portion of the item contains a record of all MICR line information required for substitute checks under Reg. CC; the item meets the technical requirements for an electronic item as set forth in the operating circular;</td>
<td>Applies interbank only</td>
</tr>
</tbody>
</table>

Applies to Items Exchanged through Federal Reserve
## SECTION FOUR – EXHIBITS

<table>
<thead>
<tr>
<th>Source /Type</th>
<th>Return Warranty or Other Responsibility</th>
<th>Application to Banks and/or Customers</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Federal Reserve – Regulation J</strong> § 210.12(e)(1)(i)</td>
<td>(ii) No person will receive transfer, presentment, or return of, or otherwise be charged for, electronic item, original item, or a paper or electronic representation of electronic item such that the person will be asked to make payment based on an item it already has paid. (no double debit)</td>
<td>Applies interbank only</td>
</tr>
<tr>
<td><strong>Federal Reserve – Regulation J</strong> § 210.12(e)(1)(iii)</td>
<td>Warranties for all returned checks that are electronic items Reserve Bank that sends returned check that is electronic item make the returning bank warranties set forth in and subject to the terms of 12 C.F.R § 229.34(c) for an electronic item as if it were a check subject to that section.</td>
<td>Applies interbank only</td>
</tr>
<tr>
<td><strong>Federal Reserve – Regulation J</strong> § 210.12 (e)(1)(iii)(A)</td>
<td>Warranties for returned checks that are not representations of Substitute Checks If the returned item that is an electronic item that is not a representation of a substitute check, the Reserve Bank warrants to the bank to which it sends the returned check – (i) Electronic image portion of item accurately represents all of information on front and back of original check as of the time the original check was truncated; information portion of item contains a record of all MICR line information required for substitute checks under Reg. CC; item meets technical requirements for electronic item as set forth in the operating circular; (ii) No person will receive a transfer, presentment, or return of, or otherwise be charged for, the electronic item, original item, or paper or electronic representation of electronic item such that the person will be asked to make payment based on item it already paid. (no double debit)</td>
<td>Applies interbank only</td>
</tr>
</tbody>
</table>
**SECTION FOUR – EXHIBITS**

**EXHIBIT 8: RETURN INDEMNIFICATION**

<table>
<thead>
<tr>
<th>Source /Type</th>
<th>Return Indemnity or Other Liability Responsibility</th>
<th>Application to Banks and/or Customers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reg CC - Check 21 Substitute Check Indemnity § 229.53</td>
<td>Bank that transfers, presents, or returns a substitute check or other representation of a substitute check for which it receives consideration indemnifies the recipient and any subsequent recipient for any loss incurred from receipt of substitute check if the loss occurred due to receipt of substitute check instead of original item.</td>
<td>Indemnity could arise from return of electronic check created from a substitute check under ECCHO Rules based exchange.</td>
</tr>
<tr>
<td>ECCHO Operating Rules Returning Member Indemnity for Breach of Warranties § XX(J)</td>
<td>If Returning Member breaches any of its warranties set forth in Section XX(J), it indemnifies Returnee Member and holds Returnee Member harmless from and against any damage, expense or loss, including attorneys’ fees, suffered as a result of the breach.</td>
<td>Applies interbank to ECCHO members only</td>
</tr>
<tr>
<td>ECCHO Operating Rules Returnee Member Indemnity for Breach of Warranties § XX(K)</td>
<td>If Returnee Member breaches any of its warranties set forth in Section XX(K), it indemnifies Returning Member and holds Returning Member harmless from and against any damage, expense or loss, including attorneys’ fees, suffered as a result of the breach.</td>
<td>Applies to ECCHO members only</td>
</tr>
</tbody>
</table>

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4 This summary is provided for general educational purposes only and should not be relied upon by any person as legal advice. As a summary, this document does not provide a complete description of all claims, defenses or exceptions that may be available to a bank in a particular check exchange. Note: Regulation J and Federal Reserve Operating Circular 3 (OC 3) are interdependent, and neither were available in final form when this Guide was updated. Therefore, only the 2018 effective versions for both Regulation J and OC 3 are covered in this Guide, in the 2019 NCP training and on any related questions on the 2019 NCP Exam.
### SECTION FOUR – EXHIBITS

<table>
<thead>
<tr>
<th>Source /Type</th>
<th>Return Indemnity or Other Liability Responsibility</th>
<th>Application to Banks and/or Customers</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ECCHO Operating Rules</strong>&lt;br&gt;Returning Member Responsibility for Check 21 Liability incurred by Returnee Member&lt;br&gt;§ XX(L)**</td>
<td>If an electronic returned check, that is returned to Returnee Member under these Rules, is subsequently converted by Reconverting Bank into substitute check and Reconverting Bank incurs liability under Check 21 Act or Subpart D (<em>Substitute Checks</em>) of Regulation CC as result of act or omission of Member, Reconverting Bank shall have recourse to Member or other bank to extent Reconverting Bank’s liability under Check 21 Act or Subpart D of Regulation CC resulted from act or omission of Member.</td>
<td>Applies to ECCHO members only</td>
</tr>
<tr>
<td><strong>Federal Reserve – Regulation J&lt;br&gt;§ 210.12(c)(5)(i)</strong></td>
<td>Paying Bank or returning bank agrees to indemnify each Reserve Bank for any loss or expense sustained (including attorney fees and expenses of litigation) from:&lt;br&gt;(A) Paying or returning bank’s lack of authority to give the authorization;&lt;br&gt;(B) Any action taken by the Reserve Bank within the scope of its authority in handling the item;&lt;br&gt;(C) Any warranty or indemnity made by the Reserve Bank in this section and under Regulation CC</td>
<td>Applies interbank only&lt;br&gt;Applies to Items Exchanged through Federal Reserve</td>
</tr>
<tr>
<td><strong>Federal Reserve – Regulation J&lt;br&gt;§ 210.12(e)(1)(iii)(B)</strong></td>
<td>If the returned check is an electronic item that is not a representation of a substitute check:&lt;br&gt;(1) Reserve Bank agrees to indemnify the bank to which it sends the returned check (the recipient bank) for the amount of any losses that the bank incurs under Subpart D of Reg. CC for an indemnity that the recipient bank was required to make under Subpart D in connection with a substitute check later created from the returned check.&lt;br&gt;(2) Reserve Bank shall not be liable for any amount that the recipient bank pays under subpart D of Reg. CC that is attributable to the lack of good faith or failure to exercise ordinary care of the recipient bank or a person that handled the item, in any form, after the recipient bank.</td>
<td>Applies interbank only&lt;br&gt;Applies to Items Exchanged through Federal Reserve</td>
</tr>
</tbody>
</table>
This section outlines the forward warranties and related indemnities for Regulation J as they will be listed in the final rule to be effective January 1, 2019. The regulation was not updated at the same time as Regulation CC which took effect July 1, 2018.

<table>
<thead>
<tr>
<th>Source /Type</th>
<th>Warranty or Other Responsibility</th>
<th>Application to Banks and/or Customers</th>
</tr>
</thead>
</table>
| Federal Reserve – Regulation J  
Sender’s Warranties Regarding Item  
§ 210.5(a)(1)  
§ 210.5(a)(2) | Sender warrants to each Reserve Bank handling the item that the sender has authority to authorize the Reserve Bank to handle the item.  
Sender warrants to each Reserve Bank handling the item that:  
(iv) The sender is a person entitled to enforce the item (or is authorized to obtain payment of the item on behalf of a person entitled to enforce the item);  
(v) The item has not been altered; and  
(vi) The item bears all indorsements applied by parties that previously handled the item for forward collection or return. | Applies to items exchanged through Reserve Bank |
| Federal Reserve – Regulation J  
Sender’s Reg CC and UCC Warranties  
§ 210.5(a)(3) | Sender of an item makes to the Reserve Bank all the warranties set forth in and subject to the terms Subpart C (Collection of Checks) and Subpart D (Substitute Checks) of Regulation CC and Article 4 of the UCC.  
Sender makes all the warranties set forth in and subject to the terms of 4-207 of the UCC for an electronic check as if it were an item subject to the UCC. | This provision applies the Reg CC warranties for electronic checks, as well as other Reg CC and UCC warranties.  
Applies to items exchanged through Reserve Bank |

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5 This summary is provided for general educational purposes only and should not be relied upon by any person as legal advice. As a summary, this document does not provide a complete description of all claims, defenses or exceptions that may be available to a bank in a particular check exchange. Note: Regulation J and Federal Reserve Operating Circular 3 (OC 3) are interdependent, and neither were available in final form when this Guide was updated. Therefore, only the 2018 effective versions for both Regulation J and OC 3 are covered in this Guide, in the 2019 NCP training and on any related questions on the 2019 NCP Exam.
<table>
<thead>
<tr>
<th>Source /Type</th>
<th>Warranty or Other Responsibility</th>
<th>Application to Banks and/or Customers</th>
</tr>
</thead>
</table>
| **Federal Reserve – Regulation J**  
Sender’s Warranties set forth in Operating Circular #3  
§ 210.5(a)(4) | Sender makes any warranties regarding the sending of items as set forth in Operating Circular #3. | Applies to items exchanged through Reserve Bank |
| **Federal Reserve – Regulation J**  
Reserve Bank’s Warranties Regarding Item  
§ 210.6(b)(1) | Reserve Bank warrants to a subsequent collecting bank and to the paying bank and any other payor that:  
(iv) The Reserve Bank is a person entitled to enforce the item (or is authorized to obtain payment of the item on behalf of a person entitled to enforce the item);  
(v) The item has not been altered; and  
(vi) The item bears all indorsements applied by parties that previously handled the item for forward collection or return. | Applies interbank only.  
 Applies to items exchanged through Reserve Bank |
| **Federal Reserve – Regulation J**  
Reserve Bank’s Reg CC and UCC Warranties  
§ 210.6(b)(3) | Reserve Bank makes all the warranties set forth in and subject to the terms of Subpart C (Collection of Checks) and Subpart D (Substitute Checks) of Regulation CC and Article 4 of the UCC.  
Reserve Bank makes all the warranties set forth in and subject to the terms of 4-207 of the UCC for an electronic check as if it were an item subject to the UCC. | Applies interbank only.  
 Applies to items exchanged through Reserve Bank.  
Note: This provision applies the Reg CC warranties for electronic checks, as well as other Reg CC and UCC warranties |
| **Federal Reserve – Regulation J**  
Reserve Bank’s Warranties set forth in Operating Circular #3  
§ 210.6(b)(2) | The Reserve Bank makes any warranties regarding the sending of items as set forth in Operating Circular #3. | Applies interbank only.  
 Applies to items exchanged through Reserve Bank. |
<table>
<thead>
<tr>
<th>Source /Type</th>
<th>Indemnity or Other Liability or Responsibility</th>
<th>Application to Banks and/or Customers</th>
</tr>
</thead>
</table>
| Federal Reserve – Regulation J                                              | Sender indemnifies each Reserve Bank for any loss or expense sustained (including attorney fees and expenses of litigation) resulting from: (A) The sender’s lack of authority to make the warranty to the Reserve Bank, under Section 210.5(a)(1) of Regulation J, that the sender has authority to authorize the Reserve Bank to handle the item; (B) Any action taken by the Reserve Bank within the scope of its authority in handling the item; and (C) Any warranty or indemnity made by the Reserve Bank under Section 210.6(b) of Regulation J, Regulation CC, the U.C.C., or, regarding the sending of items, an operating circular. | Applies interbank only
|                                                                              |                                                                                                                                                                                                                                                                                                           | Applies to items exchanged through Reserve Bank.                         |
| Federal Reserve – Regulation J                                              | The sender of an item makes to each Reserve Bank that handles the item all the indemnities set forth in and subject to the terms of Subparts C (Collection of Checks) and D (Substitute Checks) of Regulation CC and Article 4 of the U.C.C.                                                                                     | Applies interbank only
| Sender’s Reg CC and UCC Indemnities                                          |                                                                                                                                                                                                                                                                                                           | Applies to items exchanged through Reserve Bank.                         |
| § 210.5(a)(3)                                                               |                                                                                                                                                                                                                                                                                                           |                                                                           |
| Federal Reserve – Regulation J                                              | Sender makes any indemnities regarding the sending of items as set forth in Operating Circular #3.                                                                                                                                                                                                      | Applies interbank only
| Sender’s Indemnities set forth in Operating Circular #3                      |                                                                                                                                                                                                                                                                                                           | Applies only to items exchanged through Reserve Bank.                    |
| § 210.5(a)(4)                                                               |                                                                                                                                                                                                                                                                                                           |                                                                           |
## SECTION FOUR – EXHIBITS

<table>
<thead>
<tr>
<th>Source /Type</th>
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<th>Application to Banks and/or Customers</th>
</tr>
</thead>
</table>
| **Federal Reserve – Regulation J**  
Reserve Bank’s Reg CC and UCC Indemnities  
§ 210.6(b)(3)** | Reserve Bank makes to the subsequent collecting bank and the paying bank all the indemnities set forth in and subject to the terms of Subpart C (Collection of Checks) and Subpart D (Substitute Checks) of Regulation CC and Article 4 of the UCC. | Applies interbank only  
Applies only to items exchanged through Reserve Bank. |
| **Federal Reserve – Regulation J**  
Reserve Bank’s Indemnities set forth in Operating Circular #3  
§ 210.6(b)(2)** | The Reserve Bank makes any indemnities regarding the sending of items as set forth in Operating Circular #3. | Applies interbank only  
Applies only to items exchanged through Reserve Bank. |
| **Federal Reserve – Regulation J**  
Reserve Bank Indemnity for Certain Substitute Check Liability  
§ 210.6(b)(4)(i)** | Reserve Bank shall indemnify the bank to which it transfers or presents an electronic check (the recipient bank) for the amount of any losses that the recipient bank incurs under Subpart D (Substitute Checks) of Reg. CC for an indemnity that the recipient bank was required to make under Subpart D in connection with a substitute check later created from the electronic check. | Applies interbank only  
Applies to items exchanged through Reserve Bank. |
SUPPLEMENTAL INFORMATION – PART II: Return Warranties AND RELATED INDEMNITIES– Regulation J – 2019

This section outlines the return warranties and related indemnities for Regulation J as they will be listed in the final rule to be effective January 1, 2019. The regulation was not updated at the same time as Regulation CC which took effect July 1, 2018.

<table>
<thead>
<tr>
<th>Source /Type</th>
<th>Warranty or Other Responsibility</th>
<th>Application to Banks and/or Customers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal Reserve – Regulation J Paying Bank or Returning Bank Warranty for Indorsements § 210.12(c)(2)</td>
<td>The paying bank or returning bank warrants to each Reserve Bank handling the returned check that the returned check bears all indorsements applied by parties that previously handled the returned check for forward collection or return.</td>
<td>Applies interbank only Applies to items exchanged through Reserve Bank.</td>
</tr>
<tr>
<td>Federal Reserve – Regulation J Paying Bank or Returning Bank Reg CC Warranties § 210.12(c)(3)</td>
<td>The paying bank or returning bank makes to each Reserve Bank that handles the returned check all the warranties set forth in and subject to the terms of Subpart C (Collection of Checks) and Subpart D (Substitute Checks) of Regulation CC.</td>
<td>Applies to items exchanged through Reserve Bank</td>
</tr>
<tr>
<td>Federal Reserve – Regulation J Reserve Bank Warranty for Indorsements § 210.12(e)(1)(i)</td>
<td>Reserve Bank warrants to the bank to which it sends the returned check that the returned check bears all indorsements applied by parties that previously handled the returned check for forward collection or return.</td>
<td>Applies interbank only Applies to items exchanged through Reserve Bank.</td>
</tr>
</tbody>
</table>

This summary is provided for general educational purposes only and should not be relied upon by any person as legal advice. As a summary, this document does not provide a complete description of all claims, defenses or exceptions that may be available to a bank in a particular check exchange. Note: Regulation J and Federal Reserve Operating Circular 3 (OC 3) are interdependent, and neither were available in final form when this Guide was updated. Therefore, only the 2018 effective versions for both Regulation J and OC 3 are covered in this Guide, in the 2019 NCP training and on any related questions on the 2019 NCP Exam.
<table>
<thead>
<tr>
<th>Source /Type</th>
<th>Warranty or Other Responsibility</th>
<th>Application to Banks and/or Customers</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Federal Reserve – Regulation J</strong> Reserve Bank Reg CC Warranties § 210.12(e)(1)(ii)</td>
<td>Reserve Bank makes to the bank to which it sends the returned check all the warranties set forth in and subject to the terms of Subpart C (<em>Collection of Checks</em>) and Subpart D (<em>Substitute Checks</em>) of Regulation CC.</td>
<td>Applies to items exchanged through Reserve Bank.</td>
</tr>
</tbody>
</table>
## SECTION FOUR – EXHIBITS

<table>
<thead>
<tr>
<th>Source /Type</th>
<th>Indemnity or Other Liability or Responsibility</th>
<th>Application to Banks and/or Customers</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Federal Reserve – Regulation J</strong>&lt;br&gt;Paying Bank or Returning Bank Indemnity for Handling Returned Check&lt;br&gt;§ 210.12(c)(4)(i)**</td>
<td>Paying bank or returning bank agrees to indemnify each Reserve Bank for any loss or expense sustained (including attorney fees and expenses of litigation) from:&lt;br&gt;(A) Paying bank’s or returning bank’s lack of authority to give the authorization to Reserve Bank to handle the returned check under Section 210.12(c)(1) of Regulation J;&lt;br&gt;(B) Any action taken by the Reserve Bank within the scope of its authority in handling the returned check; or&lt;br&gt;(C) Any warranty or indemnity made by the Reserve Bank under Section 210.12(e) of Regulation J or under Regulation CC.</td>
<td>Applies interbank only&lt;br&gt;Applies to items exchanged through Reserve Bank.</td>
</tr>
<tr>
<td><strong>Federal Reserve – Regulation J</strong>&lt;br&gt;Paying Bank or Returning Bank Reg CC Indemnities&lt;br&gt;§ 210.12(c)(3)**</td>
<td>The paying bank or returning bank makes to each Reserve Bank that handles the returned check all the indemnities set forth in and subject to the terms of Subpart C (Collection of Checks) and Subpart D (Substitute Checks) of Regulation CC.</td>
<td>Applies to items exchanged through Reserve Bank.</td>
</tr>
<tr>
<td><strong>Federal Reserve – Regulation J</strong>&lt;br&gt;Reserve Bank Reg CC Indemnities&lt;br&gt;§210.12(e)(1)(ii)**</td>
<td>Reserve Bank makes to the bank to which it sends the returned check all the indemnities set forth in and subject to the terms of Subpart C (Collection of Checks) and Subpart D (Substitute Checks) of Regulation CC.</td>
<td>Applies interbank only&lt;br&gt;Applies to items exchanged through Reserve Bank.</td>
</tr>
</tbody>
</table>
### SECTION FOUR – EXHIBITS

<table>
<thead>
<tr>
<th>Source /Type</th>
<th>Indemnity or Other Liability or Responsibility</th>
<th>Application to Banks and/or Customers</th>
</tr>
</thead>
</table>
| **Federal Reserve – Regulation J**  
Reserve Bank Indemnity for Certain Substitute Check Liability  
§ 210.12(e)(2) | The Reserve Bank shall indemnify the bank to which it sends the electronic returned check (the recipient bank) for the amount of any losses that the bank incurs under Subpart D (*Substitute Checks*) of Reg. CC for an indemnity that the recipient bank was required to make under Subpart D in connection with a substitute check later created from the electronic returned check. | Applies interbank only  
Applies to items exchanged through Reserve Bank |
| **Federal Reserve – Regulation J**  
Sender’s Indemnities Regarding Item  
§ 210.5(a)(5)(i) | Sender indemnifies each Reserve Bank for any loss or expense sustained (including attorney fees and expenses of litigation) resulting from:  
(A) The sender’s lack of authority to make the warranty to the Reserve Bank, under Section 210.5(a)(1) of Regulation J, that the sender has authority to authorize the Reserve Bank to handle the item;  
(B) Any action taken by the Reserve Bank within the scope of its authority in handling the item; and  
(C) Any warranty or indemnity made by the Reserve Bank under Section 210.6(b) of Regulation J, Regulation CC, the U.C.C., or, regarding the sending of items, an operating circular. | Applies interbank only  
Applies to items exchanged through Reserve Bank |
SECTION FOUR – EXHIBITS

EXHIBIT 9: RETURN REASON CODES

The following reference materials are from the approved standard ANSI X9.100-188-2016, “Return Reasons for Check Image Exchange and IRDs”. This standard provides the list of Return Reason codes that are used by the industry for image exchange and the creation of IRDs.

The codes originally defined in both the ANSI X9.100-187 and ANSI X9.100-140 standards are now removed from those standards for future releases.

Selected sections of the X9.100-188 standard are shown in this exhibit. The information is reprinted here with permission of the Accredited Standards Committee X9, Incorporated -- Financial Industry Standard, Annapolis, Maryland.

- For additional information on X9 standards, or to obtain a copy of these standards, please visit the website at: www.x9.org
6 Return Reason Codes

This section provides a list of all acceptable return reason codes used for check image exchange and IRD creation. Return Reason codes are populated in the X9.100-187 file within a Return Record (Type 31) and in a Return Addendum D Record (Type 35). The Return Reason may also be carried on a Check Detail Addendum C Record (Type 28) associated with a previously returned and re-presented item. Users of this standard should take note that there are multiple ways to resolve exceptions (i.e., as Customer Returns (dishonor), or as Administrative Returns, or as Adjustments). Financial Institutions should evaluate all options to determine the appropriate method to use, based on the circumstances.

The return reasons are arranged in two group types:

- Customer Returns
- Administrative Returns

Customer return codes and Administrative return codes cannot be commingled within the same returns cash letter in an X9.100-187 file. Customer return codes are used when the Returns Indicator (Field 14) in Cash Letter Header Record (Type 10) is equal to ‘R’. Administrative return codes are used when the Returns Indicator (Field 14) in Cash Letter Header Record (Type 10) is equal to ‘E’.

While all returns carry monetary value, the generally accepted distinction is between returns that result from attempting to charge a customer’s account (Customer) and returns by the bank for some administrative reason. Alternately, administrative return reasons could be handled through an adjustment process. If administrative return reasons are handled as returns, they typically would have to adhere to the legal requirements for returns including, for example, timeliness, proper delivery and notification.

6.1 Note on codes 'I' and 'Q'

Two codes 'I' and 'Q' can be used in both Customer and Administrative returns with different meanings depending on whether they are within a Customer Return or an Administrative Return cash letter. All other return codes that are shared between Customer and Administrative returns have the same meaning.

6.2 Customer Return Reason Codes

The following codes can be used when the return of the payment can be processed within the legally allowed return timeframes. Return payments that fall outside those timeframes may need to be handled as adjustments. Financial Institutions will make their own determination as to how to handle items that fall outside the return timeframes.

Customer Returns are sent to the Return Location as defined within Regulation CC. A Customer Return Reason code distinguishes to the presenting bank the reason for non-payment when an item is dishonored. Customer Return items are usually charged to a customer account.
<table>
<thead>
<tr>
<th>Code</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>‘A’</td>
<td>NSF - Not Sufficient Funds</td>
</tr>
<tr>
<td>‘B’</td>
<td>UCF - Uncollected Funds Hold</td>
</tr>
<tr>
<td>‘C’</td>
<td>Stop Payment</td>
</tr>
<tr>
<td>‘D’</td>
<td>Closed Account</td>
</tr>
<tr>
<td>‘E’</td>
<td>UTLA - Unable to Locate Account</td>
</tr>
<tr>
<td>‘F’</td>
<td>Frozen/Blocked Account–Account has Restrictions placed on it by either customer or bank</td>
</tr>
<tr>
<td>‘G’</td>
<td>Stale Dated</td>
</tr>
<tr>
<td>‘H’</td>
<td>Post Dated</td>
</tr>
<tr>
<td>‘I’</td>
<td>Endorsement Missing</td>
</tr>
<tr>
<td>‘J’</td>
<td>Endorsement Irregular</td>
</tr>
<tr>
<td>‘K’</td>
<td>Signature(s) Missing</td>
</tr>
<tr>
<td>‘L’</td>
<td>Signature(s) Irregular, Suspected Forgery</td>
</tr>
<tr>
<td>‘M’</td>
<td>Non-Cash Item (Non-Negotiable)</td>
</tr>
<tr>
<td>‘N’</td>
<td>Altered/Fictitious Item/Suspected Counterfeit/Counterfeit</td>
</tr>
<tr>
<td>‘O’</td>
<td>Unable to Process (e.g. Unable to process physical item/Mutilated such that critical payment information is missing). This code shall not be used for unusable images or system problems (see code ‘U’</td>
</tr>
<tr>
<td>‘P’</td>
<td>Item outside of stated dollar amount limit</td>
</tr>
<tr>
<td>‘Q’</td>
<td>Not Authorized (Includes Drafts)--Unauthorized item such as a draft</td>
</tr>
<tr>
<td>‘R’</td>
<td>Branch/Account Sold (Wrong Bank)--Divested Account, Not Our Item</td>
</tr>
<tr>
<td>‘S’</td>
<td>Refer to Maker</td>
</tr>
<tr>
<td>‘T’</td>
<td>Item cannot be re-presented (Exceeds number of allowable times the item can be presented)</td>
</tr>
<tr>
<td>‘U’</td>
<td>Unusable Image (Image could not be used for required business purpose, e.g. gross image defects, illegible, etc.)</td>
</tr>
<tr>
<td>‘W’</td>
<td>Cannot Determine Amount--Amount cannot be verified</td>
</tr>
<tr>
<td>‘X’</td>
<td>Refer to Image--Return Reason information is contained within the image of the item</td>
</tr>
<tr>
<td>‘Y’</td>
<td>Duplicate Presentment (Supporting documentation shall be readily available)</td>
</tr>
<tr>
<td>‘Z’</td>
<td>Forgery--An affidavit shall be available upon request</td>
</tr>
<tr>
<td>‘3’</td>
<td>Warranty Breach (Includes Rule 8 &amp; 9 claims)</td>
</tr>
<tr>
<td>‘4’</td>
<td>RCC Warranty Breach (Rule 8)</td>
</tr>
<tr>
<td>‘5’</td>
<td>Forged and Counterfeit Warranty Breach (Rule 9)</td>
</tr>
<tr>
<td>‘6’</td>
<td>Retired/Ineligible/Failed Institution Routing Number</td>
</tr>
<tr>
<td>‘7’</td>
<td>Reserved for Future Use by X9</td>
</tr>
<tr>
<td>‘8’</td>
<td>Reserved for Future Use by X9</td>
</tr>
<tr>
<td>‘9’</td>
<td>Reserved for Future Use by X9</td>
</tr>
<tr>
<td>‘0’</td>
<td>Reserved for Future Use by X9</td>
</tr>
</tbody>
</table>
6.3 Administrative Return Reason Codes
Administrative Returns are typically sent to the bank that presented the forward item which may not be the Return Location as defined in Regulation CC.

<table>
<thead>
<tr>
<th>Code</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>‘I’</td>
<td>Image Missing</td>
</tr>
<tr>
<td>‘Q’</td>
<td>Ineligible</td>
</tr>
<tr>
<td>‘T’</td>
<td>Item cannot be re-presented (Exceeds number of allowed times the item can be presented)</td>
</tr>
<tr>
<td>‘U’</td>
<td>Unusable Image (Image could not be used for required business purpose e.g. gross image defects, illegible, etc.)</td>
</tr>
<tr>
<td>‘V’</td>
<td>Image Fails Security Check</td>
</tr>
<tr>
<td>‘Y’</td>
<td>Duplicate Presentment (Supporting documentation shall be readily available)</td>
</tr>
<tr>
<td>‘2’</td>
<td>Does not conform to the Industry’s Universal Companion Document, TR 47</td>
</tr>
<tr>
<td>‘3’</td>
<td>Warranty Breach (includes Rule 8 &amp; 9 claims)</td>
</tr>
<tr>
<td>‘4’</td>
<td>RCC Warranty Breach (Rule 8)</td>
</tr>
<tr>
<td>‘5’</td>
<td>Forged and Counterfeit Warranty Breach (Rule 9)</td>
</tr>
<tr>
<td>‘6’</td>
<td>Retired/Ineligible/Failed Institution Routing Number</td>
</tr>
</tbody>
</table>

6.4 Use of Return Reason Codes in Image Replacement Documents (IRD)
Locations and characteristics for printing both Short Name and Overlay Abbreviation are specified in ANSI X9-100-140.

6.4.1 Short Name and Overlay Abbreviations
This clause provides the Short Name and the Overlay Abbreviation as required in ANSI X9.100-140 for printing of an IRD, which shall be used for all currently defined Return Reason codes.

<table>
<thead>
<tr>
<th>Code</th>
<th>Short Name</th>
<th>Overlay Abbreviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>NOT SUFFICIENT FUNDS</td>
<td>NSF</td>
</tr>
<tr>
<td>B</td>
<td>UNCOLLECTED FUNDS HOLD</td>
<td>UNCOLLECT HOLD</td>
</tr>
<tr>
<td>C</td>
<td>STOP PAYMENT</td>
<td>STOP PAYMENT</td>
</tr>
<tr>
<td>D</td>
<td>CLOSED ACCOUNT</td>
<td>CLOSED ACCOUNT</td>
</tr>
<tr>
<td>E</td>
<td>UNABLE TO LOCATE ACCT</td>
<td>UN LOCATE ACCT</td>
</tr>
<tr>
<td>F</td>
<td>FROZEN/BLOCKED ACCOUNT</td>
<td>FROZ/BLOCK ACC</td>
</tr>
<tr>
<td>G</td>
<td>STALE DATED</td>
<td>STALE DATED</td>
</tr>
<tr>
<td>H</td>
<td>POST DATED</td>
<td>POST DATED</td>
</tr>
</tbody>
</table>
## SECTION FOUR – EXHIBITS

<table>
<thead>
<tr>
<th>Code</th>
<th>Short Name</th>
<th>Overlay Abbreviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>ENDOREMENT MISSING</td>
<td>ENDORSE MISS</td>
</tr>
<tr>
<td>I*</td>
<td>IMAGE MISSING (*administrative return)</td>
<td>IMAGE MISSING</td>
</tr>
<tr>
<td>J</td>
<td>ENDOREMENT IRREGULAR</td>
<td>ENDORSE IRR</td>
</tr>
<tr>
<td>K</td>
<td>SIGNATURE(S) MISSING</td>
<td>SIG MISS</td>
</tr>
<tr>
<td>L</td>
<td>SIGNATURE(S) IRREGULAR</td>
<td>SIG IRR</td>
</tr>
<tr>
<td>M</td>
<td>NON-CASH ITEM</td>
<td>NON CASH ITEM</td>
</tr>
<tr>
<td>N</td>
<td>ALTERED/FICTITIOUS</td>
<td>ALTER/FICT</td>
</tr>
<tr>
<td>O</td>
<td>UNABLE TO PROCESS</td>
<td>UN PROCESSABLE</td>
</tr>
<tr>
<td>P</td>
<td>OUTSIDE DOLLAR AMOUNT</td>
<td>OUTSIDE LIMITS</td>
</tr>
<tr>
<td>Q</td>
<td>NOT AUTHORIZED</td>
<td>NOT AUTHORIZED</td>
</tr>
<tr>
<td>Q*</td>
<td>INELIGIBLE (*administrative return)</td>
<td>INELIGIBLE</td>
</tr>
<tr>
<td>R</td>
<td>BRANCH/ACCOUNT SOLD</td>
<td>BRCH/ACCT SOLD</td>
</tr>
<tr>
<td>S</td>
<td>REFER TO MAKER</td>
<td>REFER TO MAKER</td>
</tr>
<tr>
<td>T</td>
<td>DO NOT RE-PRESENT</td>
<td>NOT RE-PRESENT</td>
</tr>
<tr>
<td>U</td>
<td>UNUSABLE IMAGE</td>
<td>UNUSABLE IMAGE</td>
</tr>
<tr>
<td>V</td>
<td>IMAGE FAILS SECURITY</td>
<td>FAIL SEC CK</td>
</tr>
<tr>
<td>W</td>
<td>CANNOT DETERMINE AMT</td>
<td>CANT DET AMT</td>
</tr>
<tr>
<td>X</td>
<td>REFER TO IMAGE</td>
<td>REFER TO IMAGE</td>
</tr>
<tr>
<td>Y</td>
<td>DUPLICATE PRESENTMENT</td>
<td>DUPLICATE</td>
</tr>
<tr>
<td>Z</td>
<td>FORGERY</td>
<td>FORGERY</td>
</tr>
<tr>
<td>1</td>
<td>NONCOMPLIANT TIFF</td>
<td>NONCOM TIFF</td>
</tr>
<tr>
<td>2</td>
<td>NONCONFORM UCD</td>
<td>NONCON UCD</td>
</tr>
<tr>
<td>3</td>
<td>WARRANTY BREACH</td>
<td>WARRANTY BREAC</td>
</tr>
<tr>
<td>4</td>
<td>RCC WARRANTY BREACH</td>
<td>RCC BREACH</td>
</tr>
<tr>
<td>5</td>
<td>FORGED &amp; COUNT BREACH</td>
<td>FORGED BREACH</td>
</tr>
</tbody>
</table>
SECTION FOUR – EXHIBITS

<table>
<thead>
<tr>
<th>Code</th>
<th>Short Name</th>
<th>Overlay Abbreviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>6</td>
<td>RETIRED ROUTING NUMBER</td>
<td>RETIRED RT</td>
</tr>
</tbody>
</table>

6.4.2 Default Reason Code
This clause provides the Short Name and the Overlay Abbreviation, as required in ANSI X9.100-140 for printing of an IRD, which shall be used for any Return Reason code not defined in Clause 6.4.1.

<table>
<thead>
<tr>
<th>Short Name</th>
<th>Overlay Abbreviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>UNDEFINED REASON CODE</td>
<td>UNDEFINED RR</td>
</tr>
</tbody>
</table>
The following review questions and related answers are listed in the same order as presented in each specific topic area throughout the “Section Two – Training” portion of this guide. Each main heading shows the section and topic where the questions were covered in these training materials.

## C. CHECK PAYMENTS

<table>
<thead>
<tr>
<th>Review Questions</th>
<th>Answers</th>
</tr>
</thead>
<tbody>
<tr>
<td>What do Article 3 and Article 4 of the Uniform Commercial Code (UCC) cover?</td>
<td>Articles 3 and 4 of the UCC apply directly to uniform check law and work in combination with Federal Reserve regulations and operating circulars.</td>
</tr>
</tbody>
</table>
|                                                                                 | • Article 3 deals with negotiable instruments such as checks, money orders or traveler’s checks  
• Article 4 covers bank deposits and collections                                     |
| Additional Information:                                                          |                                                                                                                                            |
|                                                                                 | The purpose and policies of the UCC, as defined in the first article, are to:                                                               |
|                                                                                 | • Simplify, clarify, and modernize the law governing commercial transactions                                                              |
|                                                                                 | • Permit the continued expansion of commercial practices through custom, usage, and agreement of the parties                               |
|                                                                                 | • Make uniform the law among the various jurisdictions.                                                                                  |
|                                                                                 |                                                                                                                                            |
| What does Federal Reserve Regulation CC implement?                               | Regulation CC (Reg CC) implements both The Check Clearing for the 21st Century Act (the Check 21 Act) and the Expedited Funds Availability Act (the EFA Act). |
| Additional Information:                                                          | Reg CC – Subpart A § 229.1 states: (a) Authority and purpose. This part is issued by the Board of Governors of the Federal Reserve System (Board) to implement the Expedited Funds Availability Act (12 U.S.C. 4001–4010) (the EFA Act) and the Check Clearing for the 21st Century Act (12 U.S.C. 5001–5018) (the Check 21 Act). |
| Where are the electronic check and the electronic returned check defined?         | Regulation CC §229.2 (ggg): Electronic check and electronic returned check: An electronic image of, and electronic information derived from, a paper check or paper returned check respectively, that:                             |
|                                                                                 | • Is sent to a receiving bank by agreement between sender and the receiving bank; and                                                      |
|                                                                                 | • Conforms with ANS X9.100-187 standard.                                                                                                   |
### C. CHECK PAYMENTS

<table>
<thead>
<tr>
<th>Review Questions</th>
<th>Answers</th>
</tr>
</thead>
</table>
| Describe the following check routing number in fractional form and define each part? | The ABA Routing Number, also referred to as the ABA number or Routing Transit number, may be shown on a check in MICR form and in the form of a fraction. For the fractional form, the numerator includes:  
  - City prefix – 1-49 or  
  - State prefix – 50-99;  
  Prefix is followed by the ABA institution identifier (zero-suppressed)  
  Denominator is 4-digit Federal Reserve routing symbol  
  In the fractional form the ABA and Federal Reserve numbers match corresponding numbers in MICR form without leading zeros. In general, the fractional form may be used to determine how to route an item if the MICR line is damaged. It can also be used for fraud control by comparing the MICR line information to the fractional form information. |
| **Fractional RT = 91-03/1221** | **Additional Information:**  
  The ABA assigns routing numbers through their official registrar, Accuity. The ABA Routing Number, also referred to as the ABA number or Routing Transit number, was developed by the ABA to identify the specific financial institution responsible for the payment of a negotiable instrument. Every financial institution in the United States has at least one of these and a single institution may have multiple RTNs.  
  It is estimated there are about 27,000 active RTNs currently in use. |
| The aux on-us field on a check is typically used for what purpose? | The auxiliary on-us field, or aux on-us, is an optional field to the left of the routing field on the MICR line of a check. If an External Processing Code (EPC) is included in the MICR line, the Auxiliary On-Us field will appear to the left of it.  
  The aux on-us field is typically used on business-sized checks for the placement of consecutive serial numbers. Checks with an aux-on-us field are ineligible to conversion to ACH entries ARC, BOC, POP.  
  **Additional Information:**  
  NACHA Operating Rules § 2.5.13.4  
  - RCK Ineligible Items -- Does not list “checks with aux-on us field” as ineligible. It does state in § 2.5.13.3 that an eligible must be a consumer account, not a commercial account. |
## D. OTHER PAYMENT SYSTEMS

<table>
<thead>
<tr>
<th>Review Questions</th>
<th>Answers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Describe the participants involved in a typical ACH transaction.</td>
<td>Participants involved in a typical ACH transaction include:</td>
</tr>
<tr>
<td></td>
<td>• Originator – Originating company or individual</td>
</tr>
<tr>
<td></td>
<td>─ Entity who agrees to initiate ACH entries into the payment system</td>
</tr>
<tr>
<td></td>
<td>─ Originator is usually a company directing transfer of funds to or from a receiver’s account (consumer or another company)</td>
</tr>
<tr>
<td></td>
<td>─ Originator may also be a merchant</td>
</tr>
<tr>
<td></td>
<td>• ODFI – Originating Depositary Financial Institution</td>
</tr>
<tr>
<td></td>
<td>─ Entity who receives the payment instructions from Originator and forwards them to the ACH Operator</td>
</tr>
<tr>
<td></td>
<td>• ACH Operator:</td>
</tr>
<tr>
<td></td>
<td>─ Central clearing facility that receives entries from ODFIs</td>
</tr>
<tr>
<td></td>
<td>─ Distributes the entries to the appropriate RDFIs</td>
</tr>
<tr>
<td></td>
<td>─ Performs the settlement functions for the financial institutions.</td>
</tr>
<tr>
<td></td>
<td>• Two organizations act as ACH Operators:</td>
</tr>
<tr>
<td></td>
<td>─ Federal Reserve</td>
</tr>
<tr>
<td></td>
<td>─ Electronic Payments Network (EPN) of The Clearing House (TCH)</td>
</tr>
<tr>
<td></td>
<td>• RDFI – Receiving Depositary Financial Institution (RDFI)</td>
</tr>
<tr>
<td></td>
<td>─ Entity that receives ACH entries from the ACH Operator and posts them to the account of its depositors (Receivers)</td>
</tr>
<tr>
<td></td>
<td>• Receiver – Receiving company, employee or customer</td>
</tr>
<tr>
<td></td>
<td>─ Entity may be a consumer or organization that has authorized an originator to initiate an ACH entry to the Receiver’s account with the RDFI</td>
</tr>
<tr>
<td>What are the dollar limits for ACH check conversion?</td>
<td>Depends on the SEC code.</td>
</tr>
<tr>
<td></td>
<td>Generally, it is $25,000 with $2,500 limit for some items</td>
</tr>
<tr>
<td>Additional Information:</td>
<td>See Exhibit 4 in this guide “ACH Check Conversion and Selected SEC Codes Overview”</td>
</tr>
</tbody>
</table>
### D. OTHER PAYMENT SYSTEMS

<table>
<thead>
<tr>
<th>Review Questions</th>
<th>Answers</th>
</tr>
</thead>
</table>
| What is Wire Transfer and when would it generally be used?                        | Wire transfer refers to large dollar, instantaneous electronic funds transfers characterized by large dollar transactions with immediate availability that are irrevocable payments. To “wire funds” is to transfer cash value from one bank to another with almost immediate availability of the funds. Wire Transfers are governed by:  
  - UCC Article 4A  
  - Regulation J (for Fed Wire); and  
  - CHIPS Rules and Administrative Procedures  
Examples of domestic payment systems offering financial wire transfer services include the Clearing House Interbank Payments System (CHIPS) of The Clearing House and Fedwire of the Federal Reserve. |
## E. RULES AND AGREEMENTS

<table>
<thead>
<tr>
<th>Review Questions</th>
<th>Answers</th>
</tr>
</thead>
<tbody>
<tr>
<td>What options are available in the U.S. for image exchange rules coverage?</td>
<td>Operating Circular 3 (OC3) applies to the handling of all cash items accepted for forward collection and all returned checks accepted for return by the Federal Reserve</td>
</tr>
<tr>
<td></td>
<td>• The Fed is itself a party to the sending and receiving of items under these rules</td>
</tr>
<tr>
<td></td>
<td>• Incorporates Federal and State regulations (Reg J, Reg CC and UCC) regarding check processing, and</td>
</tr>
<tr>
<td></td>
<td>• Includes any additional Reserve Bank provisions for Fed exchanges</td>
</tr>
<tr>
<td></td>
<td><strong>Private Sector Image Exchange Rules</strong></td>
</tr>
<tr>
<td></td>
<td>ECCHO Rules – apply to the forward collection and/or return of electronic checks/electronic returned checks between ECCHO members that agree to exchange under the ECCHO Rules</td>
</tr>
<tr>
<td></td>
<td>• ECCHO is not a direct party to the exchanges</td>
</tr>
<tr>
<td></td>
<td>• Participation under Rules is voluntary, but once agreed must conform to Rules provisions</td>
</tr>
<tr>
<td></td>
<td>• Incorporates Federal and State regulations (Reg CC and UCC) regarding check processing</td>
</tr>
<tr>
<td></td>
<td>• May vary by agreement between exchanging members</td>
</tr>
<tr>
<td></td>
<td><strong>Bi-lateral or Multi-lateral Agreements</strong> – unique rules for exchanging images between two or more parties respectively, and outline specific areas of interest for that exchange</td>
</tr>
<tr>
<td></td>
<td>• Must be renegotiated for each new relationship added outside of the bi- or multi-lateral exchanging parties</td>
</tr>
<tr>
<td>ECCHO Rules may be used to cover the exchange of a check image via remote deposit capture from a merchant to a depository bank. True or False?</td>
<td>False – ECCHO Rules may only be used to cover image exchanges between members that have agreed to exchange under the rules and ECCHO members may only be U.S. depository financial institutions. Images sent via remote deposit capture would be covered by an agreement between the customer and their depository bank.</td>
</tr>
</tbody>
</table>

**Additional Information:**
ECCHO is a check clearinghouse whose membership consists solely of U.S. depository institutions. ECCHO Rules are clearinghouse rules under the UCC and only apply only to members of the clearinghouse and only govern electronic check/electronic returned check exchanges between two Members. ECCHO members may not use (whether by private agreement of the parties or otherwise) the ECCHO Rules to attempt to govern transactions between the Member and a non-Member entity.
### E. RULES AND AGREEMENTS

<table>
<thead>
<tr>
<th>Review Questions</th>
<th>Answers</th>
</tr>
</thead>
<tbody>
<tr>
<td>What is a Banking Practice Agreement?</td>
<td>Agreements work in conjunction with the rules and specify certain processing and logistical aspects for image exchanges. Such agreements, sometimes called a Banking Practice Agreement (BPA), outline specific operational aspects for the exchanges and may be incorporated with other network or clearing house rules</td>
</tr>
</tbody>
</table>
### F. REGULATORY ENVIRONMENT

<table>
<thead>
<tr>
<th>Review Questions</th>
<th>Answers</th>
</tr>
</thead>
</table>
| How is a negotiable instrument defined? | The Uniform Commercial Code (UCC § 3-104) defines a negotiable instrument as –
|                                        | • a written promise or order  
|                                        | • to pay a specified amount of money, although interest may be added,  
|                                        | • to the person named on the instrument, or to the bearer of the instrument,  
|                                        | • on demand or at a fixed future time  
|                                        | • without the requirement for the person promising payment to perform any act in addition to paying the money specified |

**Additional Information:**

UCC § 3-104. NEGOTIABLE INSTRUMENT.

(a) "Negotiable instrument" means an unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order, if it:

1. is payable to bearer or to order at the time it is issued or first comes into possession of a holder;
2. is payable on demand or at a definite time; and
3. does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money

(b) "Instrument" means a negotiable instrument.

(e) An instrument is a "note" if it is a promise and is a "draft" if it is an order. If an instrument falls within the definition of both "note" and "draft," a person entitled to enforce the instrument may treat it as either.

(f) "Check" means (i) a draft, other than a documentary draft, payable on demand and drawn on a bank or (ii) a cashier’s check or teller’s check. An instrument may be a check even though it is described on its face by another term, such as "money order."

See UCC § 3-104 for additional details.

| What is a noncash item? | Noncash item would otherwise be a check, except that:  
|-------------------------|-------------------------------------------------------------------------------------------------|
|                         | • A passbook, certificate or other document is attached  
|                         | • It is accompanied by special instructions, such as a request for special advice of payment or dishonor  
|                         | • Consists of more than a single thickness of paper; except a check that qualifies for handling by automated check processing equipment or  
|                         | • It has not been preprinted or post-encoded in magnetic ink with the routing number of the paying bank  
|                         | • It is a Foreign item |
## F. REGULATORY ENVIRONMENT

<table>
<thead>
<tr>
<th>Review Questions</th>
<th>Answers</th>
</tr>
</thead>
</table>
| **What is another term for a “stale-dated check” and what is a bank’s responsibility under the UCC to pay such an item?** | Stale dated (also called “antedated”) item is defined by UCC-404 as an item that is more than six months old.  
*Additional Information:*  
UCC states that a bank is not obligated to pay a check more than six months after issue; but it may charge its customer's account for a payment made thereafter in good faith.  
Additional information:  
- Date is the date of its issue or the date it first comes into possession of a holder. |
| **In the case of an item with differing courtesy and legal amounts (contradictory terms), which amount prevails?** | The legal amount.  
*Additional Information:*  
UCC provides clarification on differing amounts on an item (§ 3-114) under “Contradictory Terms of Instrument”:  
- If an instrument contains contradictory terms, typewritten terms prevail over printed terms, handwritten terms prevail over both, and words prevail over numbers. |
| **What is the difference between a Holder and a Holder in Due Course?** | A “holder” is a person that comes into possession of a negotiable instrument that is payable to the bearer or to an identified person that possesses the instrument (UCC § 1-201)  
A “holder in due course” is a type of holder  
- Person that takes a check for value, in good faith and without notice that the check is overdue, altered or has been dishonored  
- Holder in due course claim may not be made if the item is overdue (more than 90 days after the date of the check) or if the holder has notice that the check contains an unauthorized signature or has been altered or that the payment of the check is subject to certain defenses or subject to certain claims. The check also must not bear apparent evidence of forgery or alteration or otherwise be incomplete (UCC § 3-302). |
## F. REGULATORY ENVIRONMENT

<table>
<thead>
<tr>
<th>Review Questions</th>
<th>Answers</th>
</tr>
</thead>
<tbody>
<tr>
<td>How did the Dodd-Frank Act amend the Expedited Funds Availability Act?</td>
<td>It required depositary institutions to make the first $200 of funds deposited by certain checks (checks not already available for next-day withdrawal) available for next-day withdrawal.</td>
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<td></td>
<td><strong>Additional Information:</strong></td>
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<tr>
<td></td>
<td>Effective July 21, 2011; see § 1086 of the Dodd-Frank Act. The first $200 (previously $100), or the total amount of the deposit if it is less than $200, of non-“next-day” checks must be made available the next day.</td>
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<tr>
<td></td>
<td>• Note: Amount to be adjusted for inflation every 5 years</td>
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<td></td>
<td>o Increase to be based upon the CPI as published by Bureau of Labor Statistics, rounded to the nearest multiple of $25</td>
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<tr>
<td></td>
<td>Next-day availability: Reg CC §229.10 states when deposits of various types are made, the funds must be made available to a bank’s customer the next business day following the banking day on which the deposit is made. The following types of deposits must be made available on the first business day following the banking day of deposit (“next-day availability”):</td>
</tr>
<tr>
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<td>• Cash</td>
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<td></td>
<td>• Electronic payments (under other rules, funds for most electronic deposits are made available on the day of deposit)</td>
</tr>
<tr>
<td></td>
<td>• Check deposits made in person –</td>
</tr>
<tr>
<td></td>
<td>o U.S. Postal Service Money Orders</td>
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<td></td>
<td>o Checks drawn on the Federal Reserve</td>
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<td>o State or local government checks</td>
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<td></td>
<td>o Cashier’s, certified, or teller’s checks</td>
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<tr>
<td></td>
<td>o On-us checks</td>
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<tr>
<td></td>
<td>• Check deposits made in person or at a proprietary ATM –</td>
</tr>
<tr>
<td></td>
<td>• U.S. Treasury checks deposited in an account held by a payee of the check</td>
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</table>
### F. REGULATORY ENVIRONMENT

<table>
<thead>
<tr>
<th>Review Questions</th>
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</thead>
<tbody>
<tr>
<td>What is a Notice of Nonpayment?</td>
<td>When a paying bank determines not to pay a check $5,000 or more it must provide notice of nonpayment to the depositary bank by 2:00 p.m. (local time) on the second business day following the banking day on which the check was presented. Such notice may be provided by any reasonable means. The returned check can be the notice.</td>
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<td><strong>Additional Information:</strong></td>
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<tr>
<td></td>
<td>See Reg CC § 229.31 (c) Notice of nonpayment</td>
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<tr>
<td></td>
<td>Notice requirements: To the extent available to the paying bank, notice must include the information contained in the check’s MICR line when the check is received by the paying bank, as well as:</td>
</tr>
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<td>• Name of the payee(s);</td>
</tr>
<tr>
<td></td>
<td>• Amount;</td>
</tr>
<tr>
<td></td>
<td>• Date of the indorsement of the depositary bank;</td>
</tr>
<tr>
<td></td>
<td>• Bank name, routing number, and trace or sequence number associated with the indorsement of the depositary bank; and</td>
</tr>
<tr>
<td></td>
<td>• Reason for nonpayment</td>
</tr>
<tr>
<td>What is the RDC Indemnity under provisions of Reg CC?</td>
<td>Indemnity provided by a depositary bank that:</td>
</tr>
</tbody>
</table>
|                                                                                 | • Is a truncating bank because it accepts remote deposit of an electronic image or other electronic information related to an original check;  
• Does not receive the original check;  
• Receives settlement for electronic check or substitute check related to the original check; and  
• Does not receive a return of the check unpaid                                                                                                                                                                                                                     |
|                                                                                 | Indemnity is provided to a depositary bank that:                                                                                                                                                                                                                                                                                          |
|                                                                                 | • Accepts the original check for deposit;  
• Receives a return or adjustment of that check; and  
• Incurs a loss if loss is due to the check having already been paid  
• Note: May not make an indemnity claim if original check it accepted for deposit bore a restrictive indorsement inconsistent with the means of deposit                                                                                                                               |
### F. REGULATORY ENVIRONMENT

<table>
<thead>
<tr>
<th>Question</th>
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<tbody>
<tr>
<td>What is the ECI Indemnity under provisions of Reg CC?</td>
<td>Indemnity provided by each bank that transfers or presents an electronically-created item and receives a settlement or other consideration. Indemnity provided to: Each transferee bank, any subsequent collecting bank, the paying bank, and any subsequent returning bank against losses from receipt of the electronic image or electronic information that is not derived from a paper check; • Unauthorized (not authorized in the amount or to the payee stated on the item) • Duplicate (charged for an electronically-created item based on an item or check already paid) Additional Information: See Reg CC § 229.34 (g) Indemnities with respect to electronically-created items</td>
</tr>
<tr>
<td>Are electronically-created items eligible for exchange under ECCHO Rules or Fed OC 3?</td>
<td>No – only items derived from a paper check are considered eligible for image exchange Additional Information: • ECCHO Operating Rules: Items Eligible for Imaging o An Electronic Check is eligible for exchange if the Image is an image of an item and the item is a paper “check” as defined under Reg CC • Federal Reserve Operating Circular (2018) o Item handled by the Reserve Bank includes cash items, returned checks and data captured from a cash item or returned check sent in the form of an electronic item, if the data was captured from a paper check</td>
</tr>
</tbody>
</table>
### G. WARRANTIES AND INDEMNIFICATION

<table>
<thead>
<tr>
<th>Review Questions</th>
<th>Answers</th>
</tr>
</thead>
<tbody>
<tr>
<td>List the four presentment warranties outlined in UCC 4-208(a) that are made by the</td>
<td>UCC 4-208(a) Person presenting the item warrants:</td>
</tr>
<tr>
<td>person presenting the item?</td>
<td>(1) Entitled to enforce draft or authorized to obtain payment or acceptance of the draft on behalf of a person entitled to enforce the draft;</td>
</tr>
<tr>
<td></td>
<td>(2) Item has not been altered; and</td>
</tr>
<tr>
<td></td>
<td>(3) Warrantor has no knowledge that signature of the purported drawer of the draft is unauthorized; and</td>
</tr>
<tr>
<td></td>
<td>(4) For RCC, person on whose account the item is drawn authorized item and amount for which it is drawn</td>
</tr>
<tr>
<td>Under Federal law, the Remotely Created Check (RCC) warranty can be found in which</td>
<td>Regulation CC – Transfer and Presentment Warranty with Respect to a Remotely Created Check § 229.34 (b)</td>
</tr>
<tr>
<td>regulation and section?</td>
<td><strong>Additional Information:</strong></td>
</tr>
<tr>
<td></td>
<td>Section 229.34 (b) states:</td>
</tr>
<tr>
<td></td>
<td>(1) A bank that transfers or presents a remotely created check and receives a settlement or other consideration warrants to the transferee bank, any subsequent collecting bank, and the paying bank that the person on whose account the remotely created check is drawn authorized the issuance of the check in the amount stated on the check and to the payee stated on the check.</td>
</tr>
<tr>
<td>Where are the electronically-created item (ECI) and ECI Indemnity defined?</td>
<td>Regulation CC 229.2 Definitions (hhh) Electronically-created item:</td>
</tr>
<tr>
<td></td>
<td>• An electronic image that has all the attributes of an electronic check or electronic returned check but was created electronically and not derived from a paper check.</td>
</tr>
<tr>
<td></td>
<td>Reg CC 229.34 (g) Indemnities with respect to electronically-created items</td>
</tr>
<tr>
<td></td>
<td><strong>Additional Information:</strong></td>
</tr>
<tr>
<td></td>
<td>Each bank that transfers or presents an electronically-created item and receives settlement or other consideration shall indemnify, each transferee bank, any subsequent collecting bank, the paying bank, and any subsequent returning bank against losses that result from the fact that:</td>
</tr>
<tr>
<td></td>
<td>(1) Electronic image or electronic information is not derived from a paper check;</td>
</tr>
<tr>
<td></td>
<td>(2) Person on whose account electronically-created item is drawn did not authorize the issuance of the item in amount stated or to the payee stated; or</td>
</tr>
<tr>
<td></td>
<td>(3) Person receives a transfer, presentment, or return of, or otherwise is charged for electronically-created item such that a person is asked to make payment based on an item or check it has already paid.</td>
</tr>
</tbody>
</table>
### G. WARRANTIES AND INDEMNIFICATION

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</thead>
</table>
| If an item that has been truncated is presented multiple times for payment, what warranty or warranties violation has occurred? | Warranty regarding no double debit (warranty against duplicate presentation) – Depending on the agreement for exchange and the item that is exchanged, the warranty may be found in:  

Reg CC § 229.34(a)(ii):  
No person will receive a transfer, presentment, or return of, or otherwise be charged for *electronic check or electronic returned check*, original check, substitute check, or a paper or electronic representation of a substitute check such that the person will be asked to make payment based on a check it has already paid.  

Reg CC § 229.52(a)(ii):  
No depositary bank, drawee, drawer, or indorser will receive presentment or return of, or otherwise be charged for, *the substitute check*, the original check, or a paper or electronic representation of the substitute check or original check such that that person will be asked to make a payment based on a check that it already has paid.  

ECCHO Rules § XIX(L): [For items exchanged under ECCHO Rules]  
References UCC and Regulation CC for the warranties  

Regulation J § 210.5(a)(4)(ii): Sender warrants to each Reserve Bank handling the item that –  
No person will receive a transfer, presentment, or return of, or otherwise be charged for, the electronic item, the original item, or a paper or electronic representation of the original item such that the person will be asked to make payment based on an item it already has paid.  

Regulation J § 210.6(b)(3)(i)(B): Reserve Bank warrants to a subsequent collecting bank and to the paying bank and any other payor that – No person will receive a transfer, presentment, or return of, or otherwise be charged for, the electronic item, the original item, or a paper or electronic representation of the original item such that the person will be asked to make payment based on an item it already has paid. |
### H. EXCHANGE CONSIDERATIONS: PRIVATE SECTOR AND FEDERAL RESERVE

<table>
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<tr>
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</table>
| If an item is not fully qualified, how may it be eligible for exchange under the ECCHO Rules? | ECCHO Rules, Section XIX (C) outlines image eligibility as follows:  
- Item is defined as a “check” under Section 229.2(k) of Regulation CC;  
- Item is a Fully Qualified Item; and  
- Sending Bank and the Receiving Bank have entered into an agreement and the item is eligible for imaging under that agreement.  

ECCHO Rules allow the Sending Bank and Receiving Bank, under their image exchange agreement, to exchange images of items that are not Fully Qualified – for example with As-Read or Partial MICR information. These are defined in the ECCHO Rules as:  
- As-Read MICR Information: The MICR line information obtained from an automated scanning or reading of a Related Physical Check or an Electronic Image of the Related Physical Check, without repair, modification, or manual keying of the MICR line information. The only allowable characters for inclusion in As-Read MICR Information are numerics and the special symbols allowable in MICR line information under applicable industry standards.  
- RNA Partial MICR Information: The MICR line information for the complete routing number and the amount fields obtained from a Related Physical Check or an Electronic Image of the Related Physical Check. |
| Under common image exchange rules, when does presentment occur? | Presentment is deemed to occur when both the Electronic Information and the Image are received at or made available to the Paying Bank.  

**Additional Information:**  
Under the ECCHO Rules, the Electronic Check (consisting of the Electronic Information and Image) must be provided or made available to the Receiving Bank by the applicable deadline designated by the Receiving Bank.  

An Image or Electronic Information received or made available on a day that is not a Banking Day for the Paying Bank, or after the Paying Bank’s Image Ledger Cutoff Time on a Banking Day, shall be deemed to be received by or made available at the opening of the Paying Bank’s next Banking Day. |
## H. EXCHANGE CONSIDERATIONS: PRIVATE SECTOR AND FEDERAL RESERVE

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<tr>
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</table>
| Under what circumstances would a “Claim of Damage Due to Under-Encoding” adjustment claim be filed? | Assume a check is deposited and the customer receives the correct amount, however the depositary bank makes an encoding error and subsequently presents the item to paying bank for the incorrect amount  
  - Depositary bank makes Reg CC warranty for correct encoding after issue  
  Upon discovery of the error, the depositary bank sends the ENC (encoding adjustment); however, the Paying Bank cannot collect from the drawer customer (account may be closed or may be insufficient funds to cover the ENC adjustment claim); Paying Bank then would have a claim back to the depositary bank to collect damages due to under-encoding  
  Similar claim can be filed under both Fed OC 3 rules and ECCHO Rules:  
  - ECCHO Rules: Claim of Damage Due to Under-Encoding  
  - Paying Bank is requesting credit for an under-encoded item charged to them and for which the paying bank is unable to collect the funds  
  Fed OC 3 / Online adjustments guide: Entry in Error (ERR) (Claim of Damage Due to Underencoding Adjustment)  
  - Request for credit for an underencoded item charged and for which you are unable to collect the funds  
  - Submit adjustment request to FRB using ERR ITYP  |
| Under the ECCHO Rules, what option(s) are available to make an Unauthorized RCC claim? | If Paying Bank determines it has claim under the Reg CC warranty for a remotely created check (RCC) it may:  
  - Make a claim to BOFD via return channel – under the ECCHO “Rule 8” process - § XIX(N) of the ECCHO Rules  
    - Claim made through return process but is not a return  
  - Use the adjustment claim process for an Unauthorized RCC warranty claim – § XII of the ECCHO Rules  
    - Adjustment type details outlined in Adjustments Matrix (exhibit to the ECCHO Rules)  |
| The Forged and Counterfeit Check Warranty (commonly known as Rule 9) allows an ECCHO member to send such claims directly to another ECCHO member or through the Federal Reserve. True or False? | False – The Federal Reserve Bank does not handle Rule 9 claims.  
  Claim may be sent under ECCHO Rules to another ECCHO member if that member has not opted out of participation in Rule 9. This breach of warranty claim is made via a return process but it is not a return – it is a breach of warranty claim  
  Note: Unlike Rule 8 versus the URCC adjustment, there is currently no option to make an adjustment claim for a Rule 9 item under ECCHO Rules.  |
## SECTION FOUR – EXHIBITS

### H. EXCHANGE CONSIDERATIONS: PRIVATE SECTOR AND FEDERAL RESERVE

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<tr>
<th>Review Questions</th>
<th>Answers</th>
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<tbody>
<tr>
<td>Additional Information:</td>
<td>Under the ECCHO Rules, the Sending Bank (that is Depositary Bank)</td>
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<tr>
<td></td>
<td>warrants:</td>
</tr>
<tr>
<td></td>
<td>• Signature of purported drawer is not forged or otherwise unauthorized, and/or</td>
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<td></td>
<td>• Related Physical Check is not counterfeit</td>
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<td></td>
<td>Participation is default under the ECCHO Rules however an opt-out is</td>
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<td>permitted unless the member is participating in a clearing arrangement</td>
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<td>that does not allow for the opt-out.</td>
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<td>If opt-out is cancelled (defaulting back to participation under the rules),</td>
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<td>the member cannot elect to opt-out again for 6 months.</td>
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<tr>
<td>Under the Federal Reserve Bank Operating Circular 3 (OC3), the Fed may reserve</td>
<td>True. Fed OC3 Section 3.2: We reserve the right to charge back an item if</td>
</tr>
<tr>
<td>the right not to handle an item if, in its discretion, it judges that it should</td>
<td>in our discretion we judge that circumstances require that it should</td>
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<tr>
<td>not be handled as a cash item.</td>
<td>not be handled as a cash item.</td>
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<td></td>
<td>Additional Information: Fed OC3: § 3.0 “Items We Do Not Handle as Cash</td>
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<td></td>
<td>Items”: A sender should not send to us any item if:</td>
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<td>(a) A passbook, certificate, or other document is attached to the item;</td>
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<td></td>
<td>(b) Special instructions, including a request for special advice of</td>
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<td>payment or dishonor, accompany the item;</td>
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<td></td>
<td>(c) The item (i) consists of more than a single thickness of paper, (ii)</td>
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<td>has been physically damaged such that it does not qualify for handling</td>
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<td>by high-speed check processing equipment, or (iii) has been contaminated</td>
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<td>by any hazardous substance;</td>
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<td></td>
<td>(d) The item has not been preprinted or post encoded in accordance with</td>
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<td></td>
<td>the X9.100-160,</td>
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<td></td>
<td>(e) The item does not (i) bear the routing number of the paying bank</td>
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<td>in fractional form in the upper right corner in at least 8-point type, or</td>
</tr>
<tr>
<td></td>
<td>(ii) conform to X9.100-160</td>
</tr>
<tr>
<td></td>
<td>(f) The bank on which the item is drawn has declined to pay the item</td>
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<td>two or more times.</td>
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</table>
## SECTION FOUR – EXHIBITS

<table>
<thead>
<tr>
<th>H. EXCHANGE CONSIDERATIONS: PRIVATE SECTOR AND FEDERAL RESERVE</th>
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</thead>
<tbody>
<tr>
<td><strong>Cash items and return checks sent to the Federal Reserve Bank must be indorsed according to the requirements in Reg CC. If items are received without indorsement, what does OC3 state are options available to the Federal Reserve Bank to handle such items?</strong></td>
</tr>
<tr>
<td>The general practice is to present the item as if it was indorsed.</td>
</tr>
<tr>
<td><strong>Additional Information:</strong></td>
</tr>
<tr>
<td>Operating Circular 3 (OC3) § 6.6 Indorsements</td>
</tr>
<tr>
<td>All cash items and returned checks sent to us must be indorsed in accordance with the requirements of Section 229.35 and Appendix D of Regulation CC. If we receive a cash item without the sender’s indorsement, or a returned check without a returning bank’s indorsement, we may:</td>
</tr>
<tr>
<td>(a) present or send the item as if it bore the indorsement</td>
</tr>
<tr>
<td>(b) place on the item the missing indorsement and the date we received it, or</td>
</tr>
<tr>
<td>(c) return the item for proper indorsement.</td>
</tr>
<tr>
<td><strong>Under the Fed adjustment rules describe when a PAID adjustment claim is used versus when a DUP adjustment claim may be filed?</strong></td>
</tr>
<tr>
<td>PAID error type: Used to report an item that has previously paid</td>
</tr>
<tr>
<td>DUP error type: Used for duplicate adjustment entries not for an item that paid twice.</td>
</tr>
<tr>
<td><strong>Example:</strong> If the BOFD made an encoding error, the Paying Bank’s customer reports the error and both banks send a correction for the same error</td>
</tr>
<tr>
<td><strong>Additional Information:</strong></td>
</tr>
<tr>
<td>Under the ECCHO Rules the adjustment type to report an item that has previously paid is a “Duplicate Item” adjustment type.</td>
</tr>
<tr>
<td>See the ECCHO Rules, Adjustment Matrix (Exhibit I) for more information</td>
</tr>
<tr>
<td><strong>Under the ECCHO Rules, if the Sending Bank is also the depositary bank, how must it identify itself?</strong></td>
</tr>
<tr>
<td>If Sending Bank is the Depositary Bank it must include its routing number in its electronic indorsement for the return of the electronic check.</td>
</tr>
<tr>
<td><strong>Additional Information</strong></td>
</tr>
<tr>
<td>See ECCHO Rules §XIX (E) Indorsement</td>
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</table>
## SECTION FOUR – EXHIBITS

### I. FRAUD AND RISK

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<tbody>
<tr>
<td>Image survivable check security features are designed to do what?</td>
<td>Image-survivable Check Security Features (ICSF) are designed to use cryptographic techniques and security marks to automatically validate whether a check is authentic, unaltered, uncopied and properly authorized. ICSF help prevent fraud since they remain effective after imaging.</td>
</tr>
</tbody>
</table>
| Opening accounts at two or more institutions and using “the float time” of available funds to create fraudulent balances is known as what type of fraud? | Check kiting:  
- Customer creates a continuous interchange of worthless checks  
- Involves covering overdrafts with deposits of checks creating overdrafts at another bank  

Additional Information: Image exchange with its faster clearing and additional controls has made a positive impact on this type of fraud.                                                                                                                                                                                                                                                                                                                                 |
| What is a key reason the FFIEC guidance on Remote Deposit Capture recommends strong contracts and customer agreements? | Remote Deposit Capture is a transaction delivery system, and it can introduce additional risk to the bank. FFIEC IT Examination Handbook outlines considerations for identifying and assessing new delivery system risks. The FFIEC outlined risks specific to RDC in their guidance “Risk Management of Remote Deposit Capture” which included: Legal and Compliance, Operational, and Reputational risks. Contracts and customer agreements are critical in mitigating risk to the financial institution and should be developed with help from legal counsel to clearly identify each party’s roles, responsibilities, and liabilities and should also define requirements and consequences of noncompliance. |
| Under the UCC, if a check is determined to be altered (rather than counterfeit), the Paying Bank’s liability is minimized. Describe why this is true. | Under current check law, responsibility for fraud is allocated between Paying Bank and BOFD. If an image item is disputed, may need to determine if the original check was altered vs. counterfeit. In general, based on the UCC transfer and presentment warranties:  
- Paying bank liability minimized if check is altered; Altered check claim has three years (UCC statute of limitations)  
- BOFD liability minimized if check is counterfeit; must be discovered by the Paying Bank by the UCC midnight deadline  

If the Paying Bank can assert a claim of “altered” on a disputed item, the liability is transferred to the depositary bank based upon the breach of warranty that has occurred:  
- Both the UCC Transfer and Presentment warranties state “…the Instrument/item has not been altered.”  
If the BOFD can assert a claim of counterfeit on a disputed item, the liability is with the Paying Bank as they are required to identify the counterfeit by the midnight deadline. |
## I. FRAUD AND RISK

<table>
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<tr>
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</table>
| What is a Business Continuity Plan (BCP) and why would one be needed?            | A Business Continuity Plan (BCP) establishes the basis for a financial institution to recover and resume business processes when operations have been unexpectedly disrupted. The BCP is designed to proactively mitigate the risk of service disruptions. In general, an enterprise-wide BCP strategy should:  
  - Minimize financial losses to the institution and allow the bank to continue to serve customers and financial markets with minimal disruptions  
  - Mitigate negative effects of disruptions on business operations  
  Four main steps in the BCP development process:  
    1.) Business Impact Analysis (BIA)  
      Identification of potential impact of uncontrolled non-specific events on business functions and processes  
    2.) Risk Assessment  
      Analysis of threats based upon business impact  
      Prioritization of potential disruptions based on severity  
    3.) Risk Management  
      Identification, assessment, and reduction of risk to an acceptable level  
      Development, implementation, and maintenance of a written, enterprise-wide BCP  
    4.) Risk Monitoring and Testing  
      Incorporate BIA and Risk Assessment findings into the BCP  
      Regular assessment and revision |
### J. CHECK OPERATIONS

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</table>
| Check processing operations are typically divided into Day 1 and Day 2 functions. List and describe three processes that typically occur on Day 1. | **Receipt**: Movement of cash letters (image cash letters (ICLs) or paper cash letters) between banks with related controls  
  o Inclearing or transit cash letters  
**Capture / Sort / Repair**: MICR line is mechanically read by various types of capture equipment to read/capture the MICR data information (may be physical paper items or “virtual” capture of electronic items)  
  o Sort items based upon routing criteria  
  o Reject Repair & Re-Entry – Items that could not be processed in the initial capture process  
    • Repaired to attempt to capture MICR data information in subsequent process  
    • Re-route items that require additional investigation to Exceptions staff  
    • Generally handled in next day (Day 2 function)  
**Balancing / Reconciliation / Posting**:  
  o Balancing – Verify cash letter or entry totals  
  • Review financial totals and research differences and resolve  
  o Posting to accounts – both customer and GL accounts  
| What is IQA and why is it used in check processing? | Image Quality Analysis (IQA): Image processing function that examines electronic items prior to virtual or electronic capture to ensure all items adhere to the accepted quality standards. Most systems utilize a combination of systematic IQA and manual staff review.  
  • Systematic review can provide first level rejection of any items that do not meet the parameters configured by the bank.  
  • Manual second level review can be done on any items that are rejected by the system.  
IQA failed items may be adjusted or returned based on type of error and timing. |
### SECTION FOUR – EXHIBITS

#### J. CHECK OPERATIONS

<table>
<thead>
<tr>
<th>Review Questions</th>
<th>Answers</th>
</tr>
</thead>
</table>
| What is the goal of straight-through processing?      | Straight Through Processing (STP) is the ability to receive and process transactions end-to-end utilizing electronic/automated system without intervention. In general, the goal of straight-through processing is the automation of various processes to eliminate physical movement of paper and move to more electronic or “virtual” processes. The benefits are generally faster and more cost-effective processes.  
Additional Information:  
Most banks have implemented some form of image technology in place of traditional paper processes. The business case benefits associated with STP may include:  
- Elimination of possible processing delays due to inefficient and/or manual operation  
- Acceleration of clearing by reducing the amount of time spent processing transactions  
- Minimized operational errors through reduction or elimination of the number of touch-points and exception processes  
- Reduction of transaction processing costs associated with staff, inefficient operations |
| What are examples of poor image quality?              | Common poor image quality defects include the following:  
- Excessive skew – Image is not in proper alignment  
- Too light - Image not having a sufficient number of black pixels or sufficient “contrast”  
- Too dark - Image having too many black pixels or insufficient “brightness”  
- Streaks - Image contains one or more “dark” or “light” bands that extend horizontally across most of the document image  
- Piggyback - Two or more documents are present and overlapped within the document image  
- Folded or torn corners or edges – Image is missing information due to source document being folded or torn  
- Too small/ undersize – Image’s width or height is below the minimum check size  
- Too large/ oversize – Image width or height is above the minimum check size Below minimum compression - The compressed image size is too low.  
- Above maximum compression - The compressed image size is too high.  
- Front-Rear Dimension Mismatch - Image height and width do not match between the front and rear images of the source document |
### J. CHECK OPERATIONS

<table>
<thead>
<tr>
<th>Review Questions</th>
<th>Answers</th>
</tr>
</thead>
<tbody>
<tr>
<td>List and describe three types of bank statements.</td>
<td>Statement types listed here cover both paper and image environments. Image statements and online statements are more common today as image technology has become prevalent.</td>
</tr>
<tr>
<td></td>
<td>1. Safe-keeping statement  * No physical checks included  * Check number and dollar amount provided</td>
</tr>
<tr>
<td></td>
<td>3. Online statements  * Access account information and provide statement information via online access</td>
</tr>
</tbody>
</table>
### K. STANDARDS

<table>
<thead>
<tr>
<th>Review Questions</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>What standard is used to define the specifications for an Image Replacement Document (IRD)?</td>
<td>The X9.100-140 standard provides the financial industry with a specification for an Image Replacement Document (IRD) - a machine-readable substitute document created from the image that is made from the front and back of the original check. The standard is referenced in Regulation CC Subpart D—Substitute Checks and related sections.</td>
</tr>
<tr>
<td>Must an IRD be encoded in magnetic ink in the MICR line to be considered properly prepared and the legal equivalent of the original physical check?</td>
<td>No. The X9.100-140 standard states that the use of magnetic ink is not required if the IRD (substitute check) is created for a paid item that is returned to the issuing institution’s customer as a properly paid item. In this case, the E-13B MICR font characters may be printed in non-magnetic ink; however, the IRD used for this purpose must still conform to all other requirements of the standard.</td>
</tr>
<tr>
<td>What is “TR 47 Universal Companion Document Industry Adoption of X9.100-187”?</td>
<td>In 2016, X9 created a new technical report (TR 47) for the UCD. Purpose of the Universal Companion Document (UCD) is to formalize an industry standard for check image exchange using ANS X9.100-187 standard format and a compilation of industry norms. The UCD is not intended to replace the ANS X9.100-187 standard, but rather to clarify how financial institutions should use the standard to ensure all necessary and appropriate payment data is exchanged between collecting and paying institutions.</td>
</tr>
<tr>
<td>How does the UCD require a bank to identify itself in an X9 image cash letter?</td>
<td>There are two ways in which bank indorsements are carried in the X9.100-187 standard: 1. Physical indorsements on the check image contained in the Image View Data Record (Type 52) 2. Electronic information carried in each item’s related X9 records - Forward item records: • Check Item Detail Record (Type 25) • Check Detail Addendum A Record (Type 26) • Check Detail Addendum C Record (Type 28) - Return item records: • Return Record (Type 31) • Return Addendum A Record (Type 32) • Return Addendum B Record (Type 33) • Return Addendum D Record (Type 35)</td>
</tr>
<tr>
<td>K. STANDARDS</td>
<td></td>
</tr>
<tr>
<td>--------------</td>
<td>---</td>
</tr>
</tbody>
</table>
| A bank received a Check Detail Addendum A Record (Type 26). In returning this item, what X9 record(s) are “flipped” and must be included? | Return Detail Addendum A Record (Type 32)  
**Additional Information:**  
X9.100.187 Records - Returns  
“31” record – generally mirrors “25” record on Forward side except  
- 31 record contains MICR data but does NOT include the Aux-on-us field  
- 33 record has the aux on-us field – Presence of the aux-on-us field is used to determine if item can be converted to ACH |  |
| What is the EPC digit and how is it used? | External Processing Code field: EPC is a one-digit code on the MICR line of a check which conveys special information for the correct handling or routing of a check or check data to financial institutions or other processors  
Codes used for qualified returns, identification of IRDs and identification of RCCs  
**Additional Information**  
Selected values listed here include:  
- ‘2’ – Identify return items that can be processed within the forward presentment system and delivered directly to the BOFD  
- ‘4’ – Assigned for usage in creation of a forward or return IRD conforming to the ANSI X9.100-140 standard  
- ‘5’ – Assigned for usage in the creation of a return IRD conforming to the ANSI X9.100-140 standard  
- ‘6’ – Assigned for usage as an identifier of Remotely Created Checks (RCCs) (unsigned drafts – RCCs are not signed by the drawer) |
### L. EXCEPTIONS: RETURNS AND RETURN REASON CODES

<table>
<thead>
<tr>
<th>Review Questions</th>
<th>Answer</th>
</tr>
</thead>
</table>
| Which check payments regulation(s) outline detailed reasons for returns?       | Currently, no check payments laws define return reason codes. Check payments laws (UCC and Regulation CC) generally state the following:   
  - UCC requires a Paying Bank that has determined to dishonor an item to return it by midnight of the day following presentment  
  - Reg CC requires returns be handled expeditiously so that the return will reach the depositary bank by 2:00 p.m. local time two days after presentment  
  - Reg CC further requires the Paying Bank to indicate the item is a return and the reason for the return  
  
  Only image exchange file formats identify the commonly used return reasons used to handle certain specific exception situations. |
| When creating an electronic return image file based on the current standard, which record, or records, must contain the return reason code? | Return Reason codes must be placed in Return Record (Type 31) and Return Addendum D Record (Type 35)  
  - Return Reason may be carried on Check Detail Addendum C Record (Type 28) associated with previously returned and represented item. This return reason code would be propagated to the Type 35 record when the records “flipped” for return processing. |
| What are two main types of returns?                                             | Customer and Administrative  
  - Customer returns are also called monetary returns.  
  - Administrative returns are also called administrative reasons or non-monetary returns.  
  All returns carry value regardless of type  
  
  Examples of Customer returns may include:  
  - NSF  
  - Stop pay  
  - Closed account  
  
  Examples of Administrative Reasons for returns may include:  
  - Poor quality image  
  - Ineligible item  
  - Duplicate item |
## L. EXCEPTIONS: RETURNS AND RETURN REASON CODES

<table>
<thead>
<tr>
<th>Review Questions</th>
<th>Answer</th>
</tr>
</thead>
</table>
| In some cases, the same return reason code can be used for both a Customer and an Administrative return. What record and code(s) must be used in the electronic cash letter files to indicate whether a customer or an administrative return is being sent? | The Cash Letter Header Record (Type 10) must have the Returns Indicator flag set (Field 14) to:  

- ‘R’ for Customer Return; or  
- ‘E’ for Administrative Return |
### M. CHECK PRODUCTS

<table>
<thead>
<tr>
<th>Review Questions</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>What is the commonly used definition of an image cash letter?</td>
<td>Image Cash Letter (ICL): File containing digital images of paper cash letter, including both the MICR data record and check images, that is electronically transmitted from sending bank to receiving bank.</td>
</tr>
<tr>
<td></td>
<td>ICLs can be created for presentment of all eligible items. Items eligible for image exchange generally include any item defined as a “check” under Reg CC and an “item” under UCC. This can differ based on the channel of exchange and applicable rules.</td>
</tr>
<tr>
<td></td>
<td>Single or multiple presentment point options are available to receive ICLs depending upon the clearing channels used. These may include:</td>
</tr>
<tr>
<td></td>
<td>• Correspondent Bank</td>
</tr>
<tr>
<td></td>
<td>• Clearing House</td>
</tr>
<tr>
<td></td>
<td>• Direct Presentment</td>
</tr>
<tr>
<td></td>
<td>• Federal Reserve Bank</td>
</tr>
<tr>
<td>Name three types of checks.</td>
<td><strong>Cashier’s check:</strong> Check that a bank draws on itself</td>
</tr>
<tr>
<td></td>
<td>• Drawn on a bank; bank is both drawer and drawee</td>
</tr>
<tr>
<td></td>
<td>– Signed by officer / employee of bank on behalf of the bank as drawer</td>
</tr>
<tr>
<td></td>
<td>– Direct obligation of the bank</td>
</tr>
<tr>
<td></td>
<td>• Generally provided for remittance purposes; common uses include payments that must be credited immediately upon receipt (real estate transfers, tax payments, etc.)</td>
</tr>
<tr>
<td></td>
<td><strong>Government check:</strong> Instrument payable on demand and drawn by U.S. government on government itself</td>
</tr>
<tr>
<td></td>
<td>• Generally regarded as checks, even though they are not drawn on bank</td>
</tr>
<tr>
<td></td>
<td><strong>Money order:</strong> Draft that a person may purchase from financial institution, post office or sales agent to pay a debt or transfer funds</td>
</tr>
<tr>
<td></td>
<td><strong>Remotely Created Check:</strong> Holder of account authorizes payee to draw check on account but does not sign check</td>
</tr>
<tr>
<td></td>
<td><strong>Substitute Check:</strong> Negotiable instrument created by Check 21 Act</td>
</tr>
<tr>
<td></td>
<td>• Properly prepared substitute check is legal equivalent of original item for all purposes</td>
</tr>
</tbody>
</table>
### M. CHECK PRODUCTS

<table>
<thead>
<tr>
<th>Review Questions</th>
<th>Answer</th>
</tr>
</thead>
</table>
| What is positive pay and why is it used?     | Account Reconciliation (ARP) includes a range of reconciliation products. This includes positive pay type services which are excellent fraud deterrent products. Some examples include:  
  - Positive Pay: Matches each check presented against list of checks issued  
  - Payee Positive Pay: Matches payee name from issue file to payee name on check  
  - Reverse Positive Pay: Bank sends that file to the company, where the company compares the information to its internal records  
  Additional Information:  
  - CD-ROM - Banks offer ability to provide customers with check images via CD  
    - Used by customers with large volume of check  
    - Banks index images for retrieval process  
    - Service eliminates need to store paper checks and deduces difficulty in retrieving checks for research |
| What is controlled disbursement and why is it used? | Controlled disbursement is a bank product that provides customers with information early each day of total amount of checks that will clear allowing the customers the opportunity to fund their account for the actual amount of checks posted that day. Benefits include:  
  - Early notification of day’s funding requirement to eliminate idle balances  
    - Customers can invest surplus funds or obtain additional funds, if needed  
  - Money markets active and investment rates generally more attractive in morning  
    - Short term investment rates generally move downward late in morning |
| Define three ACH check conversion products    | Accounts Receivable Entry (ARC)  
  - Single entry ACH debit initiated by an Originator to the account of a Receiver based on an eligible source document  
    - May convert check in the amount of $25,000 or less  
    - Only business checks that do not contain aux on-us field  
    - Originator retains the check  
  Bank Office Conversion Entry (BOC)  
  - Single entry ACH debit that may only be used for non-recurring in-person payments  
    - Check that has been accepted at point-of purchase, or manned bill payment locations is then converted to ACH debit during back office processing; Originator retains check for processing in back office |
### M. CHECK PRODUCTS

<table>
<thead>
<tr>
<th>Review Questions</th>
<th>Answer</th>
</tr>
</thead>
</table>
| **Point-of-Purchase Entry (POP)**                                                | • Used to initiate a one-time ACH debit entry to a Receiver’s account for in-person purchases made at point of purchase  
  o Based on written authorization and account information from source document (check)  
  o Check returned to customer                                                                 |

**Define three cash management products and state the benefits for each.**  

<table>
<thead>
<tr>
<th>Answer</th>
</tr>
</thead>
</table>
| **Positive Pay**: Service where bank automatically matches each check presented against amount and check number on list of checks issued. Other types of Positive Pay include:  
  • Payee Positive Pay: Matches the payee name from the issue file to the payee name on the check  
  • Reverse Positive Pay: Bank sends information on checks to be posted to customer to be compared (amount and check number) to its listing of checks issued  
**Benefits**: Products are very useful as fraud deterrents  
  • Customer can monitor and review checks and tell the bank whether to pay or reject any checks - Some products may allow customer to adjust/correct check amount if value was misread  
**Zero Balance Account (ZBA)**: Service that as debits are charged to the account, funds automatically transfer from the master account to cover and bring the sub-account balance to zero  
  • May also be referred to as a Sweep Account, Zero Balance Account, or Target Balance Account  
**Benefits**: Designed for customers who fund decentralized accounts from a central main account  
  • Provides ability to maintain separate accounts for accounting controls; streamlines account management to single balance  
  • Customer can easily make daily investment, purchase or payment decisions  
**Lockbox**: Service designed to provide customer with efficient way to accept payments and deposit funds received into the financial institution as early as possible; may be retail or wholesale lockbox service:  
  • Retail Lockbox: Characterized by large volume with machine readable payment coupons; relatively low dollar payments  
    o Examples include: Utilities, Installment Loans, Insurance Premiums, etc.  
  • Wholesale Lockbox: Characterized by lower volume and relatively high dollar payments, often including no payment |
### M. CHECK PRODUCTS

<table>
<thead>
<tr>
<th>Review Questions</th>
<th>Answer</th>
</tr>
</thead>
</table>
|                  | coupon or having other types of documents or correspondence included with the payment  
|                  | • Examples include: Dealer Payments, Medical Billing, Invoices, etc. |
|                  | **Benefits:** Allows the customer to avoid or reduce staff, equipment and transportation costs  
|                  | • Ensures the funds are deposited into the account(s) as early as possible |
SECTION FOUR – EXHIBITS

EXHIBIT 11: ECCHO ADJUSTMENT MATRIX

Following is an excerpt from the ECCHO Operating Rules and Commentary, Exhibit I, which provides a matrix of adjustment reasons and related requirements to file an adjustment claim under the ECCHO Rules. The codes and explanations are based on the currently approved version of the ECCHO Operating Rules and Commentary (July 1, 2018).

For more detailed information on ECCHO adjustments, or to review a complete copy of the rules, visit the ECCHO website at: www.eccho.org/rules
See ECCHO Adjustments Rules, in Section XII of the ECCHO Rules for the complete provisions for handling Adjustments. Provisions for rejection of adjustment claims are listed in Section XII(E) as follows:

- The receiving Member may either reject the request for settlement for an Adjustment Claim or initiate a second timely Adjustment Claim to reverse the settlement on the first Adjustment Claim in the following circumstances:
  a) The sending Member did not comply with Section XII or the requirements of the Adjustment Matrix,
  b) The adjustment claim does not relate to an item handled by the receiving Member,
  c) The Adjustment claim was a duplicate,
  d) The receiving Member had itself previously initiated an adjustment claim relating to the same matter, or
  e) The receiving Member has reasonable basis for concluding that the sending Member has not established the factual basis for the claim, except in situations when the adjustment claim relates to an RCC warranty.

### Adjustment Matrix

<table>
<thead>
<tr>
<th>Adjustment Reason</th>
<th>Deadline (Ranges)</th>
<th>Min $</th>
<th>With/Without Entry</th>
<th>Dr/Cr</th>
<th>Party who can Make Adj</th>
<th>Party to whom Adj Can be made</th>
<th>Information Needed</th>
<th>Group Adjust</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjustment Reversal Note: Can only be used when Party Making Claim has reference number for adjustment to reverse.</td>
<td>90 C</td>
<td>None</td>
<td>W Entry</td>
<td>Dr/Cr</td>
<td>Either Party</td>
<td>Either Party</td>
<td>Copy of Item Previous reference # Previous date charged</td>
<td>No</td>
</tr>
<tr>
<td>Adjustment Reversal Note: Can only be used when Party Making Claim has reference number for adjustment to reverse.</td>
<td>91 C – 1 year</td>
<td>None</td>
<td>W/O Entry</td>
<td>Dr/Cr</td>
<td>Either Party</td>
<td>Either Party</td>
<td>Copy of Item Previous reference # Previous date charged</td>
<td>No</td>
</tr>
</tbody>
</table>

**Explanation:** Adjustment of an item that was incorrectly adjusted. Reversal must be for a valid reason.

<table>
<thead>
<tr>
<th>Amount Error – Legal amount</th>
<th>Deadline (Ranges)</th>
<th>Min $</th>
<th>With/Without Entry</th>
<th>Dr/Cr</th>
<th>Party who can Make Adj</th>
<th>Party to whom Adj Can be made</th>
<th>Information Needed</th>
<th>Group Adjust</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Encoding Error</td>
<td>180 C</td>
<td>Federal Reserve minimum</td>
<td>W Entry</td>
<td>Dr/Cr</td>
<td>Either Party</td>
<td>Either Party</td>
<td>MICR Code Line Sequence # Item Date Amt Difference</td>
<td>No</td>
</tr>
<tr>
<td>- Misread</td>
<td>181 C - 1 year</td>
<td>Federal Reserve minimum</td>
<td>W/O Entry</td>
<td>Dr/Cr</td>
<td>Either Party</td>
<td>Either Party</td>
<td>MICR Code Line Sequence # Item Date Amt Difference</td>
<td>No</td>
</tr>
</tbody>
</table>

**Explanation:** An item was encoded for an amount different than the legal (written) amount or the written amount differs from the stated amount in the ANSI X9.100-187 image cash/return letter. Only applies to amount encoding errors.

---

7 The explanations of adjustment reasons serve as an informational guide to assist adjustment processing. These explanations do not represent a complete summary of all legal rights or claims that may arise under applicable law or the ECCHO Rules and for which a Member may seek an adjustment under the ECCHO Rules.

* For a Group Adjustment Claim, the bank making the Group Adjustment Claim may, at its option, provide the range of sequence numbers (first and last sequence number) of the items subject to the Group Adjustment Claim. All items in the range of sequence numbers must be subject to the Group Adjustment Claim. If the bank is using an Adjustment Provider, the Adjustment Provider must allow for this option.
### Exhibit I – Adjustment Matrix

<table>
<thead>
<tr>
<th>Adjustment Reason</th>
<th>Deadline (Ranges)</th>
<th>Min $</th>
<th>With/Without Entry</th>
<th>Dr /Cr</th>
<th>Party who can Make Adj</th>
<th>Party to whom Adj Can be made</th>
<th>Information Needed</th>
<th>Group Adjust</th>
</tr>
</thead>
<tbody>
<tr>
<td>Claim of Damage due to Under-encoding **</td>
<td>20 B</td>
<td>Federal Reserve minimum</td>
<td>W Entry</td>
<td>Cr</td>
<td>Receiving Party</td>
<td>Sending Party or by Agreement</td>
<td>Information from encoding error MICR Code line Original Reference # Sequence # Item Date CL date Entry date</td>
<td>No</td>
</tr>
<tr>
<td>Claim of Damage due to Under-encoding **</td>
<td>21 B – 1 year</td>
<td>Federal Reserve minimum</td>
<td>W/O Entry</td>
<td>Cr</td>
<td>Receiving Party</td>
<td>Sending Party or by Agreement</td>
<td>Information from encoding error MICR Code line Original Reference # Sequence # Item Date CL date Entry date</td>
<td>No</td>
</tr>
</tbody>
</table>

**Explanation:** Request for credit for an under-encoded item charged and for which the paying bank is unable to collect the funds.

Disposition of Item (where the item was sent) Information Adjustment Claim – Receiving Party must respond within 45 calendar days from date of request. See Section XII(E)(5).

| 1 year | None | W/O Entry | N/A | Either Party | Either Party | MICR Code line Sequence # Item Date Copy of Item | No |

**Explanation:** Request to identify where an item was presented/returned, including the routing number, and the associated cash/return letter information (date, total, bundle and sequence number).
## SECTION FOUR – EXHIBITS

### EXHIBIT I – ADJUSTMENT MATRIX

<table>
<thead>
<tr>
<th>Adjustment Reason</th>
<th>Deadline (Ranges)</th>
<th>Min $</th>
<th>With/Without Entry</th>
<th>Dr/Cr</th>
<th>Party who can Make Adj</th>
<th>Party to whom Adj Can be made</th>
<th>Information Needed</th>
<th>Group Adjust</th>
</tr>
</thead>
<tbody>
<tr>
<td>Duplicate Presentment – Item (single or multiple)</td>
<td>180 C</td>
<td>None</td>
<td>W Entry</td>
<td>Dr/Cr</td>
<td>Either Party</td>
<td>Either Party</td>
<td>For Both items MICR Code Line Sequence # Date of endorsement Cash letter totals Case # (if notified) If originally received from FRB can include only information received from FRB plus FRB reference number or copy of FRB adjustment form or advice.</td>
<td>Yes*</td>
</tr>
<tr>
<td>Duplicate Presentment – Item (single or multiple)</td>
<td>181 C - 1 year</td>
<td>None</td>
<td>W/O Entry</td>
<td>Dr/Cr</td>
<td>Either Party</td>
<td>Either Party</td>
<td>For Both items MICR Code Line Sequence # Date of endorsement Cash letter totals Case # (if notified) If originally received from FRB can include only information received from FRB plus FRB reference number or copy of FRB adjustment form or advice.</td>
<td>Yes*</td>
</tr>
</tbody>
</table>

**Explanation:** An institution received an item which it was asked to pay based on an item that it already had paid. This is for a claim arising under duplicate warranty provision under applicable law and the ECCHO Rules.
## Exhibit I – Adjustment Matrix

<table>
<thead>
<tr>
<th>Adjustment Reason</th>
<th>Deadline (Ranges)</th>
<th>Min $</th>
<th>With/Without Entry</th>
<th>Dr /Cr</th>
<th>Party who can Make Adj</th>
<th>Party to whom Adj Can be made</th>
<th>Information Needed</th>
<th>Group Adjust</th>
</tr>
</thead>
<tbody>
<tr>
<td>Entry in Error</td>
<td>20 B</td>
<td>Federal Reserve minimum</td>
<td>W Entry</td>
<td>Dr/Cr</td>
<td>Either Party</td>
<td>Either Party</td>
<td>Previous reference # in error</td>
<td>No</td>
</tr>
<tr>
<td>Adjusting Errors Settlement</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Entry in Error</td>
<td>21 B - 1 year</td>
<td>Federal Reserve minimum</td>
<td>W/O Entry</td>
<td>Dr/Cr</td>
<td>Either Party</td>
<td>Either Party</td>
<td>Previous reference # in error</td>
<td>No</td>
</tr>
<tr>
<td>Adjusting Errors Settlement</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Explanation:** A settlement accounting entry was incorrectly made, either for the wrong amount or to the wrong party.

| Expedited Recredit Note: Limited to Substitute Checks only | 120 C | None | W/O Entry | Dr/Cr  | Either Party           | Either Party                  | Follow requirements in Reg CC 229.55 | No           |

**Explanation:** Check 21 expedited recredit claim (see Reg CC).

<table>
<thead>
<tr>
<th>Late Return Claim</th>
<th>60 C</th>
<th>Federal Reserve minimum</th>
<th>W Entry</th>
<th>Dr</th>
<th>Receiving Party</th>
<th>Sending Party</th>
<th>MICR Code line Sequence # Item Date Copy of Item</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Late Return Claim</td>
<td>61 C – 1 year</td>
<td>Federal Reserve minimum</td>
<td>W/O Entry</td>
<td>Dr</td>
<td>Receiving Party</td>
<td>Sending Party</td>
<td>MICR Code line Sequence # Item Date Copy of Item</td>
<td>No</td>
</tr>
</tbody>
</table>

**Explanation:** Item was returned outside applicable return time frames.

<table>
<thead>
<tr>
<th>Late Return Disclaimer</th>
<th>20 B</th>
<th>Federal Reserve minimum</th>
<th>W Entry</th>
<th>Dr</th>
<th>Receiving Party</th>
<th>Sending Party</th>
<th>MICR Code line Sequence # Item Date Copy of Item</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Late Return Disclaimer</td>
<td>21 B – 1 year</td>
<td>Federal Reserve minimum</td>
<td>W/O Entry</td>
<td>Dr</td>
<td>Receiving Party</td>
<td>Sending Party</td>
<td>MICR Code line Sequence # Item Date Copy of Item</td>
<td>No</td>
</tr>
</tbody>
</table>

**Explanation:** Disclaimer of a late return claim adjustment.
### Exhibit I – Adjustment Matrix

<table>
<thead>
<tr>
<th>Adjustment Reason</th>
<th>Deadline (Ranges)</th>
<th>Min $</th>
<th>With/Without Entry</th>
<th>Dr/Cr</th>
<th>Party who can Make Adj</th>
<th>Party to whom Adj Can be made</th>
<th>Information Needed</th>
<th>Group Adjust</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mis-matched MICR</td>
<td>90 C</td>
<td>None</td>
<td>W Entry</td>
<td>Dr/Cr</td>
<td>Either Party</td>
<td>Either Party</td>
<td>MICR Code line Sequence # Item Date Copy of Item</td>
<td>Yes*</td>
</tr>
<tr>
<td>Mis-matched MICR</td>
<td>91 C - 1 year</td>
<td>None</td>
<td>W/O Entry</td>
<td>Dr/Cr</td>
<td>Either Party</td>
<td>Either Party</td>
<td>MICR Code line Sequence # Item Date Copy of Item</td>
<td>Yes*</td>
</tr>
</tbody>
</table>

**Explanation:** Item in which the MICR information associated with the item does not match the MICR information reflected on the image of the item. The traditional example is where the full MICR line of one item has been misaligned with the image of another item rather than a misread of a character or characters on the same item. **For an encoding error of amount only use Amount Error adjustment reason.**

This reason can be used when the code line in the Check Detail Record (Type 25) does not exactly match the code line on the original check. This reason is used for any encoding errors other than an error in amount.

<table>
<thead>
<tr>
<th>Non Conforming Image (NCI)</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th>Yes*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Image Missing</td>
<td>20 B</td>
<td>None</td>
<td>W Entry</td>
<td>Dr/Cr</td>
<td>Either Party</td>
<td>Either Party</td>
<td>MICR Code line Sequence # Item Date CL Date Type of NCI</td>
<td>Yes*</td>
</tr>
<tr>
<td>Ineligible item</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Invalid RT</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non Conforming Image (NCI)</td>
<td>21 B – 1 year</td>
<td>None</td>
<td>W/O Entry</td>
<td>Dr/Cr</td>
<td>Either Party</td>
<td>Either Party</td>
<td>MICR Code line Sequence # Item Date CL Date Type of NCI</td>
<td>Yes*</td>
</tr>
<tr>
<td>Image Missing</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ineligible item</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Invalid RT</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Explanation:** Item fails to meet image quality standards, image of item is missing, or item contains an invalid or undefined routing number (i.e. routing number not eligible for image exchange) or invalid data for specific file type or the item is ineligible for image clearing.
### SECTION FOUR – EXHIBITS

#### EXHIBIT I – ADJUSTMENT MATRIX

<table>
<thead>
<tr>
<th>Adjustment Reason</th>
<th>Deadline (Ranges)</th>
<th>Min $</th>
<th>With/Without Entry</th>
<th>Dr /Cr</th>
<th>Party who can Make Adj</th>
<th>Party to whom Adj Can be made</th>
<th>Information Needed</th>
<th>Group Adjust</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-negotiable item/Non Cash Item</td>
<td>90 C</td>
<td>None</td>
<td>W Entry</td>
<td>Dr/Cr</td>
<td>Either Party</td>
<td>Either Party</td>
<td>MICR Code line Sequence # Item Date</td>
<td>Yes*</td>
</tr>
<tr>
<td>Non-negotiable item/Non Cash Item</td>
<td>91 C - 1 year</td>
<td>None</td>
<td>W/O Entry</td>
<td>Dr/Cr</td>
<td>Either Party</td>
<td>Either Party</td>
<td>MICR Code line Sequence # Item Date</td>
<td>Yes*</td>
</tr>
</tbody>
</table>

**Explanation:** “Negotiability” is defined in the UCC (see UCC) and “Non-Cash Item” is defined in Reg CC (See Reg CC). Examples of non-cash items include items that enter collection stream in error such as empty carrier, control document, deposit/withdrawal ticket, pay stub or mutilated item, piggy back and item not encoded with magnetic ink.

| Not our item                              | 20 B              | None  | W Entry             | Dr/Cr  | Either Party           | Either Party                  | MICR Code line Sequence # Item Date    | Yes*         |
| Not our item                              | 21 B - 1 year     | None  | W/O Entry           | Dr/Cr  | Either Party           | Either Party                  | MICR Code line Sequence # Item Date    | Yes*         |

**Explanation:** In forward collection process, an item that contains routing transit number that does not belong to the institution that receives item, or the institution authorized to process the item.

In return collection process, an item that was not indorsed/handled, either physically or electronically, by the institution that receives the return item.

<table>
<thead>
<tr>
<th>Other</th>
<th>1 year</th>
<th>Federal Reserve minimum</th>
<th>W/O Entry</th>
<th>Dr</th>
<th>Receiving Party</th>
<th>Sending Party</th>
<th>MICR Code line Sequence # Item Date Copy of Item</th>
<th>No</th>
</tr>
</thead>
</table>

**Explanation:** Adjustment reason not specifically identified.

| Pricing Error Adjustment                  | N/A**             | Federal Reserve Minimum | W Entry    | Dr/Cr | Either Party | Either Party | Same as Federal Reserve                       | No |

**Explanation:** Initiated by Federal Reserve at request of Bureau of Fiscal Services (BFS) when it determines bond was redeemed for incorrect amount or was processed for incorrect amount.
## SECTION FOUR – EXHIBITS

### EXHIBIT I – ADJUSTMENT MATRIX

<table>
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<tr>
<th>Adjustment Reason</th>
<th>Deadline (Ranges)</th>
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<th>Dr /Cr</th>
<th>Party who can Make Adj</th>
<th>Party to whom Adj Can be made</th>
<th>Information Needed</th>
<th>Group Adjust</th>
</tr>
</thead>
<tbody>
<tr>
<td>Request for Information</td>
<td>1 year</td>
<td>Federal Reserve minimum</td>
<td>W/O Entry</td>
<td>Dr</td>
<td>Receiving Party</td>
<td>Sending Party</td>
<td>MICR Code line</td>
<td>No</td>
</tr>
<tr>
<td>Information Adjustment Claim – Receiving Party must respond within 45 calendar days from date of request. See Section XII(E)(5).</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Request for Original or Sufficient Copy</td>
<td>1 year</td>
<td>None</td>
<td>W/O Entry</td>
<td>Dr</td>
<td>Receiving Party</td>
<td>Sending Party</td>
<td>MICR Code line</td>
<td>No</td>
</tr>
<tr>
<td>Information Adjustment Claim – Receiving Party must respond within 45 calendar days from date of request. See Section XII(E)(5).</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Explanation:** Request for information regarding a forward, return or adjustment item.

<table>
<thead>
<tr>
<th>Return Adjustment</th>
<th>60 C</th>
<th>None</th>
<th>W Entry</th>
<th>Dr/Cr</th>
<th>Either Party</th>
<th>Either Party</th>
<th>Reason for use Item sequence number Date of Deposit Copy of item that includes (RT, Acct #, Amount, Check #)</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return Adjustment</td>
<td>61 C – 1 year</td>
<td>None</td>
<td>W/O Entry</td>
<td>Dr/Cr</td>
<td>Either Party</td>
<td>Either Party</td>
<td>Reason for use Item sequence number Date of Deposit Copy of item that includes (RT, Acct #, Amount, Check #)</td>
<td>No</td>
</tr>
</tbody>
</table>

**Explanation:** Institution seeks to adjust a return item that was incorrectly returned.

| Rule 8 & 9 Claim | Follow Rules in Section XIX(N) & (O) | None | | | | | Reason for use Item sequence number Date of Deposit Copy of item that includes (RT, Acct #, Amount, Check #) | No |
|------------------|--------------------------------------|------|--------|--------------------------|-------------|------------------------------------------------------|------|

**Explanation:** Adjustment of a warranty claim arising under either Rule 8 or Rule 9. See ECCHO Rules Section XIX(N) & (O) for explanation.

| Rule 8 & 9 - Disclaim Warranty | Follow Rules in Section XIX(N) & (O) | None | | | | | | No |
|-------------------------------|--------------------------------------|------|--------|--------------------------|-------------|------------------------------------------------------|------|

**Explanation:** Disclaimer of a warranty claim arising under either Rule 8 or Rule 9 See ECCHO Rules Section XIX(N) & (O) for explanation.
### SECTION FOUR – EXHIBITS

#### Exhibit I – Adjustment Matrix

<table>
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<tr>
<th>Adjustment Reason</th>
<th>Deadline (Ranges)</th>
<th>Min$</th>
<th>With/Without Entry</th>
<th>Dr/Cr</th>
<th>Party who can Make Adj</th>
<th>Party to whom Adj Can be made</th>
<th>Information Needed</th>
<th>Group Adjust</th>
</tr>
</thead>
<tbody>
<tr>
<td>Source of Receipt Item (A request to identify from whom an institution received an item) Information Adjustment Claim – Receiving Party must respond within 20 business days from date of request. See Section XII(E)(5).</td>
<td>1 year</td>
<td>None</td>
<td>W/O Entry</td>
<td>N/A</td>
<td>Either Party</td>
<td>Either Party</td>
<td>MICR Code line Sequence # Item Date Copy of Item</td>
<td>No</td>
</tr>
<tr>
<td>Unauthorized RCC Warranty Claim</td>
<td>90 C</td>
<td>None</td>
<td>W Entry</td>
<td>Dr</td>
<td>Receiving Party</td>
<td>Sending Party</td>
<td>MICR Code line Sequence # Item Date Copy of Item Copy of Affidavit (see sample in Exhibit VIII)</td>
<td>No</td>
</tr>
<tr>
<td>Unauthorized RCC Warranty Claim</td>
<td>91 C - 1 year</td>
<td>None</td>
<td>W/O Entry</td>
<td>Dr</td>
<td>Receiving Party</td>
<td>Sending Party</td>
<td>MICR Code line Sequence # Item Date Copy of Item Copy of Affidavit (see sample in Exhibit VIII)</td>
<td>No</td>
</tr>
</tbody>
</table>

**Explanation:**
- A request to identify from whom an institution received an item, including the routing number, and the associated cash/return letter information (date, total, bundle and sequence number).
- Adjustment of remotely created check (RCC) warranty claim arising from an RCC that was not authorized by the Paying Bank’s customer in the amount or to the payee stated on the RCC. Claims for Unauthorized RCCs can be made as an adjustment using this adjustment reason or as a Rule 8 claim using the return mechanism (See ECCHO Rules Section XIX(N)).
<table>
<thead>
<tr>
<th>Adjustment Reason</th>
<th>Deadline (Ranges)</th>
<th>Min$</th>
<th>With/Without Entry</th>
<th>Dr/Cr</th>
<th>Party who can Make Adj</th>
<th>Party to whom Adj Can be made</th>
<th>Information Needed</th>
<th>Group Adjust</th>
</tr>
</thead>
<tbody>
<tr>
<td>Warranty Indemnity Claim (WIC) For Check 21 Warranty Claims</td>
<td>1 year</td>
<td>Federal Reserve minimum</td>
<td>With Entry</td>
<td>Dr/Cr</td>
<td>Either Party</td>
<td>Either Party</td>
<td>Description of Warranty Breach, MICR Code line, Copy of Item</td>
<td>No</td>
</tr>
<tr>
<td>For Remote Deposit Capture (RDC) Indemnity Claims</td>
<td>1 year</td>
<td>Federal Reserve minimum</td>
<td>With Entry</td>
<td>Dr/Cr</td>
<td>Paper Deposit Bank</td>
<td>RDC Bank</td>
<td>Provide information requested within or complete and attach Sample RDC Indemnity Claim Letter**, or Sample RDC Indemnity Disclaim Form** as appropriate</td>
<td>No</td>
</tr>
</tbody>
</table>

Explanation: Adjustment for claim of a Check 21 Breach of Warranty/Indemnity or an RDC indemnity claim.

Wrong Payee Credit | 180 C | None | W Entry | Cr | N/A | N/A | Copy of check, Maker name, Check number, Account on Check | No |
Wrong Payee Credit | 181 C – 1 year | None | W/O Entry | Cr | N/A | N/A | Copy of check, Maker name, Check number, Account on Check | No |

Explanation: BOFD seeks to pass credit to maker’s account at Paying Bank to correct error in payee processing/credit of the item. An example would be lockbox bank posts check utility payment to entity other than the utility company payee and subsequently identifies the processing error.
SECTION FOUR – EXHIBITS

EXHIBIT 12: ECCHO AND FEDERAL RESERVE ADJUSTMENTS COMPARISON

The following table provides a comparison of selected adjustment types contrasting the name for each between the ECCHO adjustment code and the Federal Reserve investigation type (ITYP). A short description of each adjustment reason is included and serves as an informational guide only.

Note: This listing and the related explanations do not represent a complete summary of all claims that may arise under applicable law, the ECCHO Rules or Federal Reserve OC 3. For a complete listing of industry adjustments currently included in the ECCHO Rules and Matrix or those accepted for claims through the Federal Reserve Banks, go to:

- ECCHO Operating Rules and Commentary: [www.eccho.org](http://www.eccho.org)
### SECTION FOUR – EXHIBITS

<table>
<thead>
<tr>
<th>Fed Adj ITYP</th>
<th>Description</th>
<th>Timing (Same Day Entry)</th>
<th>ECCHO Adj Reason</th>
<th>Description</th>
<th>Timing (With Entry)</th>
</tr>
</thead>
<tbody>
<tr>
<td>ENC</td>
<td>Encoding Error: Item was clearly encoded for amount different than the legal (written) amount or the written amount differs from the stated amount in image cash/return letter.</td>
<td>6 months</td>
<td>Amount Error- Legal Amount - Encoding Error - Misread</td>
<td>An item was encoded for an amount different than the legal (written) amount or the written amount differs from the stated amount in the ANSI X9.100-187 image cash/return letter. Only applies to amount encoding errors. (Federal Reserve minimum)</td>
<td>180 calendar days</td>
</tr>
<tr>
<td>ERR</td>
<td>Entry in Error: Request to reverse/investigate an entry made in error</td>
<td>20 business days</td>
<td>Entry in Error - Adjusting Errors - Settlement</td>
<td>A settlement accounting entry was incorrectly made, either for the wrong amount or to the wrong party. (Federal Reserve minimum)</td>
<td>20 business days</td>
</tr>
<tr>
<td></td>
<td>Entry in Error (Claim of Damage Due to Underecoding Adjustment): Request for credit for an underencoded item charged and for which you are unable to collect the funds.</td>
<td></td>
<td>Claim of Damage due to Underecoding</td>
<td>Request for credit for an under-encoded item charged and for which the paying bank is unable to collect the funds. (Federal Reserve minimum) Note: Handled by Fed as ERR</td>
<td>20 business days</td>
</tr>
<tr>
<td>EXRC</td>
<td>Expedited Recredit: Request for expedited recredit associated with an eligible substitute check presented/returned in a cash/return letter.</td>
<td>120 Calendar days</td>
<td>Expedited Recredit</td>
<td>Check 21 expedited recredit claim. See Regulation CC</td>
<td>120 calendar days</td>
</tr>
<tr>
<td>LC</td>
<td>Late Return Claim: Depository Institution alleges an item was returned late ($100 or more)</td>
<td>2 months</td>
<td>Late Return Claim</td>
<td>Item was returned outside applicable return time frames. (Federal Reserve minimum)</td>
<td>60 calendar days</td>
</tr>
<tr>
<td>LR</td>
<td>Late Return Disclaimer: Drawee disputes the claim of late return ($100 or more)</td>
<td>20 business days</td>
<td>Late Return Disclaimer</td>
<td>Disclaimer of a Late Return adjustment claim (Federal Reserve minimum)</td>
<td>20 business days</td>
</tr>
<tr>
<td>NCH</td>
<td>Non-Cash Item: Request for credit for a non-valid item (zero-value) that was included in the cash/return letter total or an item that does not meet legal equivalence requirements for Check 21.</td>
<td>20 business days</td>
<td>Non-negotiable Item / Non Cash Item</td>
<td>Request for credit for a non-valid item. Examples include items that enter collection stream in error such as empty carrier, a control document, deposit/withdrawal ticket, pay stub or mutilated item or item not encoded with magnetic ink. Note: “Negotiability” is defined in UCC and “Non-Cash Item” defined in Reg CC</td>
<td>90 calendar days</td>
</tr>
<tr>
<td></td>
<td>Examples: An empty carrier, a control document, a deposit/withdrawal ticket, or a mutilated item. Check 21-related Non-Cash Items include situations in which the image on the substitute check does not match the MICR line on the substitute check (mismatched items), the substitute check has more than one legal legend (or no legal legend), or the substitute check is an image of image. These examples are not all inclusive.</td>
<td></td>
<td>Mis-Matched MICR</td>
<td>Item in which MICR information associated with item does not match MICR information reflected on image of item. Traditional example is full MICR line of one item has been misaligned with image of another item rather than a misread of character(s) on same item. For an encoding error of amount only use Amount Error adjustment reason. Reason can be used when code line in Check Detail Record (Type 25) does not exactly match code line on original check. Note: Handled by Fed as NCH</td>
<td>90 calendar days</td>
</tr>
</tbody>
</table>
# SECTION FOUR – EXHIBITS

<table>
<thead>
<tr>
<th>Fed Adj ITYP</th>
<th>Description</th>
<th>Timing (Same Day Entry)</th>
<th>ECCHO Adj Reason</th>
<th>Description</th>
<th>Timing (With Entry)</th>
</tr>
</thead>
<tbody>
<tr>
<td>NCI</td>
<td>Non-Conforming Item: Used by the Fed to adjust for items that failed to meet standards for image clearing. Items may be charged back to depositors if they do not conform to Fed’s quality standards, if they are ineligible for image clearing, or if they are qualified to an invalid routing number.</td>
<td>Only made by the Fed</td>
<td>Non Conforming Image (NCI)</td>
<td>Item fails to meet image quality standards, image of item is missing, or item contains an invalid or undefined routing number (i.e., routing number not eligible for image exchange) or invalid data for specific file type or the item is ineligible for image clearing.</td>
<td>20 business days</td>
</tr>
<tr>
<td>NOI</td>
<td>Not Our Item: Item was charged in cash/return letter which does not bear receiving institution’s routing number in MICR line (Forward Collection) or endorsement area (Return) of physical item or image or in the associated endorsement records for items received electronically. Note: NOI ITYP does not apply to “mismatched items”</td>
<td>20 business days</td>
<td>Not our item</td>
<td>In forward collection process, an item that contains routing transit number that does not belong to the institution that receives item or the institution authorized to process the item. In return collection process, an item that was not indorsed/handled, either physically or electronically, by the institution that receives the return item.</td>
<td>20 business days</td>
</tr>
<tr>
<td>PAID</td>
<td>Paid Item: Request for credit for an item that is being refused either because it is the original (or the legal equivalent, i.e., a substitute check) or image received in cash/return letter or a photocopy and the other item has already paid</td>
<td>6 calendar months</td>
<td>Duplicate Item</td>
<td>Institution received item which it was asked to pay based on an item that it already had paid. For claims arising under duplicate warranty provision under applicable law and ECCHO Rules.</td>
<td>180 calendar days</td>
</tr>
<tr>
<td>PEA</td>
<td>Pricing Error Adjustment: Initiated by the Fed at the behest of the Bureau of Fiscal Service (Fiscal Service) when it determines bond was redeemed for the incorrect amount or processed for the incorrect amount, subject to standard adj min amount.</td>
<td>Two weeks after cash letter date</td>
<td>Pricing Error Adjustment</td>
<td>Initiated by Fed as requested by Bureau of Fiscal Service (Fiscal Service), when it determines bond was redeemed for incorrect amount or was processed for incorrect amount. Note: Should not submit PEA adj to Fed within first 2 weeks after deposit to avoid crossing adj’s with those initiated by the Bureau of Fiscal Service. Investigation type is reserved for Federal Reserve Bank use only.</td>
<td>N/A</td>
</tr>
<tr>
<td>WIC/URCC</td>
<td>Warranty/Indemnity Claim Associated with Unauthorized Remotely Created Checks: Paying institution alleges remotely created check not authorized in the amount stated on the check to the payee indicated on the check</td>
<td>90 calendar days</td>
<td>Unauthorized RCC Warranty Claim</td>
<td>Adjustment of remotely created check (RCC) warranty claim arising from RCC that was not authorized by Paying Bank’s customer in the amount to the payee stated on the RCC. Claims for Unauthorized RCCs can be made as an adjustment using this adjustment reason or as a Rule 8 claim using the return mechanism (See ECCHO Rules Section XIX(N)).</td>
<td>90 calendar days</td>
</tr>
<tr>
<td>WIC/Check 21</td>
<td>Warranty/Indemnity Claim Associated with Check 21 Items: Depository institution alleges breach of a Check 21 warranty or indemnity</td>
<td>1 year</td>
<td>Warranty Indemnity Claim (WIC) for Check 21 Warranty Claims</td>
<td>Adjustment of a claim of a Check 21 Breach of Warranty and/or Indemnity associated with receipt of a Substitute Check or Image item.</td>
<td>1 year</td>
</tr>
</tbody>
</table>
## SECTION FOUR – EXHIBITS

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<thead>
<tr>
<th>Fed Adj ITYP</th>
<th>Description</th>
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<th>ECCHO Adj Reason</th>
<th>Description</th>
<th>Timing (With Entry)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>WIC / RDC Items</strong></td>
<td>Adjustment for claim for an RDC indemnity claim. RDC item must have been processed via FRB and RDC Bank must have received settlement through FRB for the item with no return of the item. (See Reg CC for details)</td>
<td>90 calendar days</td>
<td><strong>Warranty Indemnity Claim (WIC) for Remote Deposit Capture (RDC) Indemnity Claims</strong></td>
<td>Adjustment for claim for an RDC indemnity claim.</td>
<td>1 year</td>
</tr>
<tr>
<td><strong>WIC / UECI</strong></td>
<td>Paying institution alleges electronically created item (ECI) was not authorized by the person on whose account the electronic item was created in the amount stated on the item or to the payee stated on the item. Only one of these conditions must be met. Note: ECI defined under Regulation CC as an electronic image that has all the attributes of an electronic check or electronic returned check but was created electronically and not derived from a paper check.</td>
<td>90 calendar days</td>
<td><strong>n/a</strong></td>
<td>Not specified by ECCHO; May use manual claim letter</td>
<td></td>
</tr>
</tbody>
</table>
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<tbody>
<tr>
<td>n/a</td>
<td>Not specified by Fed</td>
<td></td>
<td>Adjustment Reversal</td>
<td>Ability to adjust an item that was incorrectly adjusted. Reversal must be for a valid reason.</td>
<td>90 calendar days</td>
</tr>
<tr>
<td>n/a</td>
<td>Not specified by Fed</td>
<td></td>
<td>Return Adjustment</td>
<td>Institution seeks to adjust a return item that was incorrectly returned.</td>
<td>60 calendar days</td>
</tr>
<tr>
<td>n/a</td>
<td>Not specified by Fed</td>
<td></td>
<td>Wrong Payee Credit</td>
<td>BOFD seeks to pass credit to maker’s account at Paying Bank to correct error in payee processing/credit of the item. Example: Lockbox bank posts check utility payment to entity other than the intended utility company payee and subsequently identifies the processing error.</td>
<td>180 calendar days</td>
</tr>
<tr>
<td>n/a</td>
<td>Not specified by Fed</td>
<td></td>
<td>Other</td>
<td>Adjustment reason not specifically identified</td>
<td>1 year</td>
</tr>
</tbody>
</table>
SECTION FOUR – EXHIBITS

EXHIBIT 13: CHECK RETENTION

The following table provides a comparison of retention requirements for check transactions based on various banking laws. This includes retention of the original check or retention of a copy of the front and back of the original check that can be retrieved within a reasonable period of time.

Note: The chart is informational only and does not constitute legal advice.
Check Retention/Retrieval Requirements

- Chart provides a comparison of retention requirements of check transactions based on various banking laws.
  - Retention means: Retention of the original check; or copy of the front and back of the original check in a manner such that it can be retrieved within a reasonable period of time

<table>
<thead>
<tr>
<th>Entity</th>
<th>Uniform Commercial Code (UCC)</th>
<th>Bank Secrecy Act (BSA)</th>
<th>Other State Laws</th>
<th>Other Considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depositary Bank</td>
<td>For truncated checks, 7 years or have arrangements to obtain copy (UCC4-406)</td>
<td>5 years or arrange for third-party to retain checks greater than $100 deposited in demand deposits; however, this requirement may be satisfied by other records maintained in the ordinary course of business enabling reconstruction and tracing of or describing check deposit (31 CFR 103.34(b)(10))</td>
<td>May require longer retention</td>
<td>Bank may determine to retain copies for longer period for depositor customer service purposes</td>
</tr>
<tr>
<td></td>
<td>For non-truncated checks, 3 years (or longer period) to defend against lawsuits under UCC (UCC4-111) or other law</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Collecting Bank (Not Paying Bank)</td>
<td>For truncated checks, 7 years or have arrangements to obtain copy (UCC4-406)</td>
<td>5 years or arrange for third-party to retain copies of certain large dollar (over $10,000) international checks or suspicious transactions (31 C.F.R. 103.34(b) and 103.18(d))</td>
<td>May require longer retention</td>
<td></td>
</tr>
<tr>
<td></td>
<td>For non-truncated checks, 3 years (or longer period) to defend against lawsuits under UCC (UCC4-111) or other law</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### SECTION FOUR – EXHIBITS

<table>
<thead>
<tr>
<th>Entity</th>
<th>Uniform Commercial Code (UCC)</th>
<th>Bank Secrecy Act (BSA)</th>
<th>Other State Laws</th>
<th>Other Considerations</th>
</tr>
</thead>
</table>
| Returning Bank (Not Paying Bank) | For truncated checks, 7 years or have arrangements to obtain copy (UCC4-406)  
For non-truncated checks, 3 years (or longer period) to defend against lawsuits under UCC (UCC4-111) or other law | 5 years or arrange for third-party to retain copies of certain large dollar (over $10,000) international checks or suspicious transactions (31 C.F.R. 103.34(b) and 103.18(d)) | May require longer retention |                                                                                        |
| Paying Bank                   | If checks not returned to drawer, 7 years or have arrangements to obtain copy (UCC 4-406)  
If checks returned to drawer, 3 years (or longer period) to defend against lawsuits under UCC (UCC 4-111) or other law | 5 years or arrange for third-party to retain, except for checks of less than $100, checks drawn on accounts with average of 100 or more checks per month, and certain types of checks  
5 years or arrange for third-party to retain copies of certain large dollar (over $10,000) international checks or suspicious transactions (31 C.F.R. 103.34(b) and 103.18(d)) | May require longer retention | Bank may determine to retain copies for longer period for drawer customer service purposes |

For more information please visit the ECCHO website: [www.eccho.org](http://www.eccho.org)

**NOTICE**

*This chart is for informational purposes only and does not constitute legal advice. Each bank should consult its own counsel to determine the check retention/retrieval laws applicable to it and its compliance with those laws.*
SECTION FOUR – EXHIBITS

EXHIBIT 14: SAMPLE MULTIPLE CHOICE EXAM

The following sample exam includes a variety of questions drawn from these training materials. A recommended approach would be to first review all sections of this guide and then attempt to answer each of the multiple-choice questions.

The sample exam includes:

- Forty-five (45) questions
  - Multiple-choice format similar to the actual NCP Exam
  - Note: No NCP exam questions are included
- Answer Key follows at the end of this exhibit
### SECTION FOUR – EXHIBITS

<table>
<thead>
<tr>
<th>1.</th>
<th>Are rules and agreements required for image exchange and if so, what is the main reason?</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>a. Yes, because current state and federal laws cover the exchange of physical checks not the electronic exchanges.</td>
</tr>
<tr>
<td></td>
<td>b. No, agreements are optional since all images exchanged are covered by the Federal Reserve operating circulars and related regulations.</td>
</tr>
<tr>
<td></td>
<td>c. Yes, because today’s cash letter processes may commingle paper checks and substitute checks which are created from previously imaged items.</td>
</tr>
<tr>
<td></td>
<td>d. No, image exchange today is covered under Regulation CC and the provisions of the Check 21 Act.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>2.</th>
<th>The commonly used definition of an image cash letter is:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>a. electronically transmitted file containing the digital images of paper checks.</td>
</tr>
<tr>
<td></td>
<td>b. electronically transmitted file of digital images of paper checks and related MICR data records.</td>
</tr>
<tr>
<td></td>
<td>c. electronic file as defined in the X9.100-140 standard.</td>
</tr>
<tr>
<td></td>
<td>d. electronic file containing ACH entries.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>3.</th>
<th>A Notice of Nonpayment as defined in Regulation CC is used to provide:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>a. the returned check to the depositary bank’s customer via US mail.</td>
</tr>
<tr>
<td></td>
<td>b. recredit to the bank’s customer for a loss due to receipt of a substitute check.</td>
</tr>
<tr>
<td></td>
<td>c. notice when the check is unavailable for return.</td>
</tr>
<tr>
<td></td>
<td>d. notice to the depositary bank that a check $5,000 or greater will not be paid.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>4.</th>
<th>Settlement generally occurs when:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>a. image cash letter files are transmitted for processing.</td>
</tr>
<tr>
<td></td>
<td>b. image cash letter files are received for processing.</td>
</tr>
<tr>
<td></td>
<td>c. funds are exchanged based upon agreement of the exchanging parties.</td>
</tr>
<tr>
<td></td>
<td>d. payment instructions are exchanged based on agreement of exchanging parties.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>5.</th>
<th>Negative float occurs when:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>a. incurred float exceeds allocated float.</td>
</tr>
<tr>
<td></td>
<td>b. bank float is greater than customer float.</td>
</tr>
<tr>
<td></td>
<td>c. customer float is greater than bank float.</td>
</tr>
<tr>
<td></td>
<td>d. mail float time exceeds processing float time.</td>
</tr>
</tbody>
</table>
### SECTION FOUR – EXHIBITS

<table>
<thead>
<tr>
<th></th>
<th>One reason a noncash item would not be defined as a check is</th>
</tr>
</thead>
<tbody>
<tr>
<td>a.</td>
<td>because it is not defined in Reg CC.</td>
</tr>
<tr>
<td>b.</td>
<td>if the check is not indorsed by the payee.</td>
</tr>
<tr>
<td>c.</td>
<td>if the check is accompanied by special instructions.</td>
</tr>
<tr>
<td>d.</td>
<td>if it is an image replacement document (IRD).</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>The aux on-us field in the MICR line of a business-sized check is typically used to:</th>
</tr>
</thead>
<tbody>
<tr>
<td>a.</td>
<td>identify an image replacement document (IRD).</td>
</tr>
<tr>
<td>b.</td>
<td>identify the financial institution routing number.</td>
</tr>
<tr>
<td>c.</td>
<td>include the drawer's account number.</td>
</tr>
<tr>
<td>d.</td>
<td>include the check serial number.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>If an item is not fully qualified, the ECCHO Rules allow it to be exchanged as an eligible item if the:</th>
</tr>
</thead>
<tbody>
<tr>
<td>a.</td>
<td>Sending Bank agrees to create and send the item as a substitute check.</td>
</tr>
<tr>
<td>b.</td>
<td>Sending and Receiving Banks agree to exchange images of items that do not contain the full MICR line.</td>
</tr>
<tr>
<td>c.</td>
<td>Receiving Bank agrees to take the liability if the check is dishonored.</td>
</tr>
<tr>
<td>d.</td>
<td>Sending Bank agrees to take the liability if the check is dishonored.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>According to the ECCHO Rules, if two members agree to exchange items that do not contain the Full MICR line, what are the options for exchanging that item as an image?</th>
</tr>
</thead>
<tbody>
<tr>
<td>a.</td>
<td>Sending Bank agrees to send the item as an imperfect image.</td>
</tr>
<tr>
<td>b.</td>
<td>Sending Bank agrees to manually key the MICR line readable from the image.</td>
</tr>
<tr>
<td>c.</td>
<td>Sending Bank agrees to send either As-Read MICR or RTA Partial MICR.</td>
</tr>
<tr>
<td>d.</td>
<td>Sending Bank agrees to create IRD first then create an image from that IRD.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>A credit card company contacts a consumer and informs him he will be receiving additional late fees on his account unless an immediate payment is received. The consumer agrees to a remotely created check (RCC) to be charged to his checking account to pay the outstanding bill and fees. The RCC is not printed but is immediately generated as an image for processing. The image is deposited at BOFD A who sends the item in an image cash letter to a correspondent (Bank B) who then presents the item to the Paying Bank. The Paying Bank then charges the item to its drawer's account. Is this a valid transaction?</th>
</tr>
</thead>
<tbody>
<tr>
<td>a.</td>
<td>No, even though authorized, the RCC did not exist as a physical item before imaging.</td>
</tr>
<tr>
<td>b.</td>
<td>Yes, the drawer authorized the remotely created check and had funds to cover the check.</td>
</tr>
<tr>
<td>c.</td>
<td>No, the intermediary correspondent (Bank B) did not have an agreement in place to exchange fully electronic remotely created checks.</td>
</tr>
<tr>
<td>d.</td>
<td>Yes, if the item is sent through the Federal Reserve Bank.</td>
</tr>
</tbody>
</table>
### SECTION FOUR – EXHIBITS

<table>
<thead>
<tr>
<th>11.</th>
<th><strong>Under the ECCHO Rules, what is one reason a Depositary Bank may disclaim a Forged and Counterfeit Check breach of warranty claim (commonly known as “Rule 9”)?</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>a.</td>
<td>Paying Bank’s customer did not provide a written statement within 120 days after account statement of check was made available.</td>
</tr>
<tr>
<td>b.</td>
<td>There were sufficient funds to pay the claim but the Depositary Bank chose not to charge their customer.</td>
</tr>
<tr>
<td>c.</td>
<td>Depositary Bank is not the first bank (BOFD) to which the check was transferred.</td>
</tr>
<tr>
<td>d.</td>
<td>The banks exchanged the item based on the provisions in the ECCHO Rules.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>12.</th>
<th><strong>Check clearing is the</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>a.</td>
<td>movement of funds for accounting purposes.</td>
</tr>
<tr>
<td>b.</td>
<td>process of converting a paper check to an image.</td>
</tr>
<tr>
<td>c.</td>
<td>process of converting an image to a substitute check.</td>
</tr>
<tr>
<td>d.</td>
<td>movement of check data from depositing bank to paying bank.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>13.</th>
<th><strong>The definition of an image replacement document is a file:</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>a.</td>
<td>as defined in the X9.100-140 standard.</td>
</tr>
<tr>
<td>b.</td>
<td>containing the digital images of paper checks.</td>
</tr>
<tr>
<td>c.</td>
<td>containing ACH entries as defined in the NACHA Rules.</td>
</tr>
<tr>
<td>d.</td>
<td>of digital images of paper checks and related MICR data records.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>14.</th>
<th><strong>The IQA process is used in check processing to:</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>a.</td>
<td>scan an item in a remote deposit capture environment prior to transmission.</td>
</tr>
<tr>
<td>b.</td>
<td>view the image of an item to verify required indorsements are present.</td>
</tr>
<tr>
<td>c.</td>
<td>examine electronic items to ensure all items adhere to accepted quality standards.</td>
</tr>
<tr>
<td>d.</td>
<td>view an image of an item to repair MICR line information prior to recapture.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>15.</th>
<th><strong>A Paying Bank has determined to dishonor an item due to insufficient funds in its drawer customer’s account. Assuming it will return the item to the depositary bank, when must it arrive at the depositary bank to be considered a timely return and where is this requirement documented?</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>a.</td>
<td>Must be received by midnight of the next banking day – Midnight deadline (UCC).</td>
</tr>
<tr>
<td>b.</td>
<td>Must be received by 2:00 pm local time of the depositary bank on the 2nd banking day following the business day of presentment – Expeditious return (Reg CC).</td>
</tr>
<tr>
<td>c.</td>
<td>Must be received by the next business day, unless otherwise varied by agreement – May be varied by agreement (UCC).</td>
</tr>
<tr>
<td>d.</td>
<td>Must be received by 2:00 pm local time of the depositary bank on the 2nd business day following the banking day of presentment – Expeditious return (Reg CC).</td>
</tr>
</tbody>
</table>
### SECTION FOUR – EXHIBITS

<table>
<thead>
<tr>
<th>Question</th>
<th>Description</th>
<th>Answer Options</th>
</tr>
</thead>
</table>
| 16.      | A Paying Bank receives a check for collection on April 15, 2018 that is dated April 30, 2018. The Paying Bank received no notice from their drawer customer about this particular item. The bank will likely | a. hold the check until the April 30 date.  
   b. return the check and charge the customer a fee.  
   c. pay the check regardless of the April 30 date.  
   d. send the check back to the presenting bank as an adjustment. |
| 17.      | Under the Fed adjustment rules, if a savings bond is redeemed or processed for an incorrect amount, the Bureau of the Fiscal Service requests the Fed to initiate what type of correction process? | a. PEA claim for error, any amount.  
   b. PEA claim for error if greater than $25.00.  
   c. ERR adjustment claim.  
   d. NCH adjustment claim. |
| 18.      | Under the Fed adjustment rules, a DUP adjustment claim is used for what type of error? | a. Not our item  
   b. Mismatch item  
   c. Duplicate paid item  
   d. Duplicate adjustment entry |
| 19.      | Under the UCC, a check that is indorsed by the payee "For Deposit Only" would be an example of what type of Payee Indorsement? | a. Special  
   b. Anomalous  
   c. Restrictive  
   d. Blank |
| 20.      | According to the Uniform Commercial Code (UCC), when is a check considered to be overdue? | a. 60 days after its date  
   b. 90 days after its date  
   c. 1 year after its date  
   d. 3 years after its date |
### SECTION FOUR – EXHIBITS

#### 21. The UCC Presentment warranties are made to the
- a. paying bank.
- b. collecting bank.
- c. depositary bank.
- d. presenting bank.

#### 22. When a Paying Bank detects a duplicate item, assuming the timing allows a return to be sent, the Paying Bank may decide to return or adjust that item. If the Paying Bank’s choice is to adjust rather than return, and they lose their right of return, generally what does this mean under check rules and regulations?
- a. The Paying Bank can only return the item as a substitute check.
- b. The Paying Bank has sent the item to a Returning Bank which will handle the return item for them.
- c. The timings permitted under UCC and Reg CC expired and the available options to handle this item are to either adjust it or send a letter for collection.
- d. The depositary bank can refuse to pay the adjustment claim since the item was not returned timely.

#### 23. The provisions that outline the warranties for a remotely created check (RCC) are found in:
- a. Regulation J.
- b. Regulation CC.
- c. image exchange agreements.
- d. Federal Reserve Operating Circular 3 (OC3).

#### 24. Regulation CC requires a paying bank that dishonors and returns a check to
- a. identify it as a return and the reason for the return.
- b. send a notice of nonpayment and the check.
- c. send a notice in lieu of return.
- d. create a substitute check.

#### 25. According to the UCC, if two or more names are listed as payees on a check, without the “or” or “and” designation or other specific instructions, then
- a. any payee listed may sign to negotiate the check.
- b. all payees listed must sign to negotiate the check.
- c. only the holder is required to sign to negotiate the check.
- d. representatives of each payee must sign to negotiate the check.
### SECTION FOUR – EXHIBITS

26. **Straight-through processing is used wherever possible in check processing today and generally refers to the**
   - a. physical handling and repair of checks.
   - b. image quality analysis process prior to capture.
   - c. balancing and reconciliation of cash letters before transmission.
   - d. automated receipt and processing of transactions without manual intervention.

27. **The Account Reconciliation (ARP) product "positive pay" is a service that:**
   - a. provides early notification of day’s funding requirement to eliminate idle balances.
   - b. is used to verify totals of items scanned and deposited via remote deposit capture.
   - c. allows banks to match each check presented against a company-provided issue list.
   - d. is used to verify control totals on image cash letter files to reconcile prior to transmission.

28. **The Account Reconciliation (ARP) product "reverse positive pay" is a service that is designed to:**
   - a. verify totals of items scanned and deposited via remote deposit capture.
   - b. verify control totals on image cash letter files to reconcile prior to transmission.
   - c. provide early notification of day’s funding requirement to eliminate idle balances.
   - d. allow a company to match checks presented against its internal records of checks issued.

29. **Under the UCC Transfer warranties, the person or collecting bank transferring the item warrants:**
   - a. all signatures on the item are authentic and authorized.
   - b. no person will be asked to make payment based on an item they already paid.
   - c. the electronic image is an accurate representation of the front and back of the original check.
   - d. they have no knowledge that the signature of the drawer is unauthorized.

30. **The UCC Transfer warranties are made**
   - a. to all parties in the collection chain.
   - b. from Depositary Bank to Collecting Bank only.
   - c. from Paying Bank to drawer customer.
   - d. to all parties in the collection chain except the Paying Bank.
### SECTION FOUR – EXHIBITS

#### 31. The UCC defines a Holder In Due Course as a:

- a. holder of the instrument, such as a financial institution, that holds the image of the paid check.
- b. holder of an instrument that took the item in good faith, for value, without knowledge of claims against it.
- c. holder of the instrument, such as a customer, that took the instrument and exchanged it for cash to receive the value of the instrument.
- d. holder of the instrument, such as a financial institution, that has returned a check to the customer and charged their account.

#### 32. If a demand for payment results in a dispute that is subject to the statute of limitations under the UCC, that maximum time period would be

- a. One year
- b. Two years
- c. Three years
- d. Seven years

#### 33. The Universal Companion Document (UCD) to the current Image Exchange standard (X9.100-187) is considered

- a. an appendix to the X9.100-187 standard.
- b. a guideline to support development of IRDs.
- c. an auxiliary standard under the X9 standards.
- d. a technical report (TR) defined by ANSI standards.

#### 34. When present on a business-sized check, the X9.100-187 image exchange standard provides for the aux on-us field to be included in which electronic records for forward and return processing?

- a. Check Detail Record (Type 25) & Return Record (Type 31)
- b. Check Detail Record (Type 25) & Return Addendum B Record (Type 33)
- c. Check Detail Addendum A Record (Type 26) & Return Addendum B Record (Type 32)
- d. Check Detail Addendum C Record (Type 28) & Return Addendum D Record (Type 35)

#### 35. Based on the X9.100-187 image exchange standard, each cash letter requires certain control records at the cash letter level. What are these record types?

- a. File header record (Type 01) and File control record (Type 99)
- b. Bundle header record (Type 20) and Bundle control record (Type 70)
- c. Cash letter header record (Type 10) and Cash letter control record (Type 90)
- d. File header record (Type 01) and Cash letter header record (Type 10) only.

#### 36. When populating the Check Detail Addendum A Record (Type 26) the information provided is used mainly to
### SECTION FOUR – EXHIBITS

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>a.</td>
<td>identify the return location.</td>
</tr>
<tr>
<td>b.</td>
<td>identify the paying bank.</td>
</tr>
<tr>
<td>c.</td>
<td>identify the subsequent indorser.</td>
</tr>
<tr>
<td>d.</td>
<td>identify the reconverting bank.</td>
</tr>
</tbody>
</table>

#### 37. A bank received a Check Detail Addendum A Record (Type 26). In returning this item, what X9 record type must be “flipped” from the Type 26 record?

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>a.</td>
<td>Check Detail Record (Type 25)</td>
</tr>
<tr>
<td>b.</td>
<td>Return Addendum A Record (Type 32)</td>
</tr>
<tr>
<td>c.</td>
<td>Check Detail Addendum C Record (Type 28)</td>
</tr>
<tr>
<td>d.</td>
<td>Return Addendum D Record (Type 35)</td>
</tr>
</tbody>
</table>

#### 38. In order to avoid a potential rejection of a re-presented item as a duplicate, what needs to be included in the X9.100-187 electronic image cash letter file?

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>a.</td>
<td>Include the Return Addendum A Record (Type 32)</td>
</tr>
<tr>
<td>b.</td>
<td>Include a second back view of the image in Image View Data Record (Type 52)</td>
</tr>
<tr>
<td>c.</td>
<td>Set truncation indicator to “Y” in the Check Detail Addendum A Record (Type 26)</td>
</tr>
<tr>
<td>d.</td>
<td>Provide a return reason code in Check Detail Addendum C Record (Type 28)</td>
</tr>
</tbody>
</table>

#### 39. A depositary bank has an agreement with a returns consolidator and chooses to have its returns sent to that organization for processing. Which X9.100-187 record would identify the actual depositary bank?

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>a.</td>
<td>Check Detail Record (Type 25)</td>
</tr>
<tr>
<td>b.</td>
<td>Check Detail Addendum A Record (Type 26)</td>
</tr>
<tr>
<td>c.</td>
<td>Check Detail Addendum B Record (Type 27)</td>
</tr>
<tr>
<td>d.</td>
<td>Check Detail Addendum C Record (Type 28)</td>
</tr>
</tbody>
</table>

#### 40. A bank may identify a remotely created check by placing what value in the EPC field of the MICR line?

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<tbody>
<tr>
<td>a.</td>
<td>2</td>
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<tr>
<td>b.</td>
<td>4</td>
</tr>
<tr>
<td>c.</td>
<td>5</td>
</tr>
<tr>
<td>d.</td>
<td>6</td>
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</table>
## SECTION FOUR – EXHIBITS

### 41. The FFIEC states the first step in a comprehensive and enterprise-wide Business Continuity Plan (BCP) is

<p>| | |</p>
<table>
<thead>
<tr>
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<tbody>
<tr>
<td><strong>a.</strong></td>
<td>Risk Management</td>
</tr>
<tr>
<td><strong>b.</strong></td>
<td>Business Impact Analysis</td>
</tr>
<tr>
<td><strong>c.</strong></td>
<td>Risk Assessment</td>
</tr>
<tr>
<td><strong>d.</strong></td>
<td>Risk Monitoring/Testing</td>
</tr>
</tbody>
</table>

### 42. When submitting an adjustment through the Federal Reserve for an unauthorized remotely created check, the correct adjustment investigation type for the claim is

<p>| | |</p>
<table>
<thead>
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<tbody>
<tr>
<td><strong>a.</strong></td>
<td>ERR</td>
</tr>
<tr>
<td><strong>b.</strong></td>
<td>NOI</td>
</tr>
<tr>
<td><strong>c.</strong></td>
<td>PAID</td>
</tr>
<tr>
<td><strong>d.</strong></td>
<td>WIC/URCC</td>
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</table>

### 43. ECCHO Rules provisions, commonly referred to as Rule 9, permit a participating member to make a breach of warranty claim to another participating member for

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<tbody>
<tr>
<td><strong>a.</strong></td>
<td>a late return.</td>
</tr>
<tr>
<td><strong>b.</strong></td>
<td>an altered check.</td>
</tr>
<tr>
<td><strong>c.</strong></td>
<td>a forged or counterfeit check.</td>
</tr>
<tr>
<td><strong>d.</strong></td>
<td>an unauthorized remotely created check.</td>
</tr>
</tbody>
</table>

### 44. In addition to a check drawn on the United States Treasury, which of the following is excluded from the Regulation CC expeditious return requirement?

<p>| | |</p>
<table>
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<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td><strong>a.</strong></td>
<td>State or local government check payable through a bank</td>
</tr>
<tr>
<td><strong>b.</strong></td>
<td>Image of check in a carrier envelope</td>
</tr>
<tr>
<td><strong>c.</strong></td>
<td>Image replacement document</td>
</tr>
<tr>
<td><strong>d.</strong></td>
<td>U.S. Postal Money Order</td>
</tr>
</tbody>
</table>

### 45. The most recent FFIEC Guidance for Retail Payment Systems, Appendix E includes considerations for

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<table>
<thead>
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<tbody>
<tr>
<td><strong>a.</strong></td>
<td>mobile remote deposit capture.</td>
</tr>
<tr>
<td><strong>b.</strong></td>
<td>risk mitigation related to new accounts.</td>
</tr>
<tr>
<td><strong>c.</strong></td>
<td>indorsement requirements for imaged checks.</td>
</tr>
<tr>
<td><strong>d.</strong></td>
<td>business continuity planning for disaster recovery.</td>
</tr>
</tbody>
</table>
EXHIBIT 14: Sample Exam – Multiple Choice Answer Key

<table>
<thead>
<tr>
<th>Question #</th>
<th>Answer</th>
<th>Question #</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>A.</td>
<td>24.</td>
<td>A.</td>
</tr>
<tr>
<td>2.</td>
<td>B.</td>
<td>25.</td>
<td>A.</td>
</tr>
<tr>
<td>4.</td>
<td>C.</td>
<td>27.</td>
<td>C.</td>
</tr>
<tr>
<td>5.</td>
<td>C.</td>
<td>28.</td>
<td>D.</td>
</tr>
<tr>
<td>6.</td>
<td>C.</td>
<td>29.</td>
<td>A.</td>
</tr>
<tr>
<td>7.</td>
<td>D.</td>
<td>30.</td>
<td>D.</td>
</tr>
<tr>
<td>8.</td>
<td>B.</td>
<td>31.</td>
<td>B.</td>
</tr>
<tr>
<td>9.</td>
<td>C.</td>
<td>32.</td>
<td>C.</td>
</tr>
<tr>
<td>10.</td>
<td>A.</td>
<td>33.</td>
<td>D.</td>
</tr>
<tr>
<td>11.</td>
<td>C.</td>
<td>34.</td>
<td>B.</td>
</tr>
<tr>
<td>12.</td>
<td>D.</td>
<td>35.</td>
<td>C.</td>
</tr>
<tr>
<td>13.</td>
<td>A.</td>
<td>36.</td>
<td>A.</td>
</tr>
<tr>
<td>14.</td>
<td>C.</td>
<td>37.</td>
<td>B.</td>
</tr>
<tr>
<td>15.</td>
<td>D.</td>
<td>38.</td>
<td>D.</td>
</tr>
<tr>
<td>16.</td>
<td>C.</td>
<td>39.</td>
<td>D.</td>
</tr>
<tr>
<td>17.</td>
<td>B.</td>
<td>40.</td>
<td>D.</td>
</tr>
<tr>
<td>18.</td>
<td>D.</td>
<td>41.</td>
<td>B.</td>
</tr>
<tr>
<td>19.</td>
<td>C.</td>
<td>42.</td>
<td>D.</td>
</tr>
<tr>
<td>20.</td>
<td>B.</td>
<td>43.</td>
<td>C.</td>
</tr>
<tr>
<td>21.</td>
<td>A.</td>
<td>44.</td>
<td>D.</td>
</tr>
<tr>
<td>22.</td>
<td>C.</td>
<td>45.</td>
<td>A.</td>
</tr>
<tr>
<td>23.</td>
<td>B.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
SECTION FOUR – EXHIBITS

EXHIBIT 15: GLOSSARY OF TERMS & COMMON ACRONYMS

This section provides a listing of commonly used payments terms and their definitions. These include generally accepted industry acronyms that relate to checks, check payments and related processes.

These are commonly used definitions in the payments industry for the terms shown in this section of the P.R.E.P. Guide. Certain terms may be worded slightly differently depending on an individual’s experience or institution’s preference.
SECTION FOUR – EXHIBITS

1. ABA - American Bankers Association
   - Trade association of American bankers
   - Has the registration authority to assign bank routing numbers

2. ABA Routing Number
   - Developed by American Bankers Association (ABA) in 1910
   - Unique, nine-digit numbers assigned to each banking institution
   - Identifies the specific financial institution responsible for payment of a negotiable instrument
   - May be referred to as ABA number, RT (routing number) or RTN (routing transit number); See also Routing Number definition

3. Account
   - Generally, means all deposit accounts as defined in Reg. D. This includes transaction, savings, MMDA and time deposit accounts

4. Account number field
   - Field on the MICR line of a check that identifies the account on which the check was drawn

5. ACH - Automated Clearing House
   - A facility that processes debit and credit transfers under rules of the automated clearinghouse association (NACHA Operating Rules and NACHA Operating Guidelines) or under rules established by a Federal Reserve Bank operating circular on automated clearinghouse items

6. ACH Format (NACHA Format)
   - Record formats as described in the NACHA Operating Rules and NACHA Operating Guidelines
   - Transactions in this format, which are defined and warranted as the ACH standard, are used for payments delivered through the ACH network

7. ACH Network
   - A batch processing, store-and-forward funds transfer system, governed by the NACHA Operating Rules
     - Provides for the interbank clearing of electronic payments for participating depository financial institutions

8. ACH Operator
   - Two central clearing facilities act as the network operators:
     - Federal Reserve and The Clearing House (TCH)

9. Adjustments
   - Debit or credit to an account to correct a transaction error.
SECTION FOUR – EXHIBITS

- Adjustments are not defined in regulations but are covered under agreements between the parties

10. Altered Check
- A negotiable instrument that has been materially and maliciously altered to affect a fraud. Usually either the name of the payee or the amount of the check is changed. UCC § 3-407 defines alteration as:
  - An unauthorized change in an instrument that purports to modify in any respect the obligation of a party, or
  - An unauthorized addition of words or numbers or other change to an incomplete instrument relating to the obligation of a party

11. Amount field
- MICR field on a check that represents the amount for which that check was written
  - Should match both the legal and courtesy amount fields written on the face of the check

12. ANSI (American National Standards Institute)
- Serves as administrator and coordinator of United States private sector voluntary standardization system. ANSI facilitates development of American National Standards (ANS) by accrediting the procedures of standards developing organizations
- These groups work cooperatively to develop voluntary national consensus standards
- Accreditation by ANSI signifies that procedures used by standards body in connection with development of American National Standards meet Institute’s essential requirements for openness, balance, consensus and due process.

13. Antedated Check
- Check or negotiable instrument with a date in the past

- Variable format, optional field in the MICR line
  - Found on a business-sized check to the left of the routing field
  - Used at the discretion of the issuing financial institution
- For more detail, see the ANSI standard X9.100-160 Magnetic Ink Printing (MICR) Part 2: EPC Field Use

15. Available for Withdrawal
- Funds deposited that are available to customer for all uses generally permitted for actually and finally collected funds
- Under the bank’s account agreement and/or policies would include:
  - Payment of checks drawn on the account
  - Electronic payments
  - Withdrawals by cash
  - Transfers between accounts
SECTION FOUR – EXHIBITS

16. Bank

- An insured institution, a mutual savings bank, a savings bank, an insured credit union, a savings association, an agency or a branch of a foreign bank, and members of a Federal Home Loan Bank
- Includes all of a bank’s offices in the United States
- "Bank" also includes any person engaged in the business of banking, as well as a Federal Reserve Bank, a Federal Home Loan Bank, and a state or unit of general local government to the extent that the state or unit of general local government acts as a paying bank and also includes the Treasury of the United States and the United States Postal Service to the extent that they act as a paying bank.

17. Bank Secrecy Act/Anti-Money Laundering (BSA/AML)

- BSA requires businesses to keep records and file reports that are determined to have a high degree of usefulness in criminal, tax, and regulatory matters
  - Documents filed by businesses under BSA requirements used by law enforcement agencies, both domestic and international to identify, detect and deter money laundering whether it is in furtherance of a criminal enterprise, terrorism, tax evasion or other unlawful activity.
- USA Patriot Act amended the Bank Secrecy Act (BSA)
  - Was intended to strengthen U.S. measures to prevent, detect, and prosecute international money laundering and the financing of terrorism. These efforts include anti-money laundering (AML) tools that impact the banking, financial, and investment communities

18. Banking Day

- That part of any business day on which an office of a bank is open to the public for carrying on substantially all of its banking functions

19. Board of Governors of the Federal Reserve System (Federal Reserve Board)

- Main governing body of the Federal Reserve system charged with overseeing the Federal Reserve Banks and with helping implement U.S. monetary policy
- Located in Washington, D.C, consists of seven appointed governors
  - Governors are appointed by the President of the United States and confirmed by the Senate for staggered 14-year terms

20. Business Day

- Calendar day other than a Saturday or a Sunday; the following dates are not considered business days:
  - January 1, the third Monday in January, the third Monday in February, the last Monday in May, July 4, the first Monday in September, the second Monday in October, November 11, the fourth Thursday in November, or December 25. If January 1, July 4, November 11, or December 25 falls on a Sunday, the next Monday is not a business day

- Business Continuity Plan is a comprehensive document that is comprised of the administrative and operational procedures established within an organization to reasonably assure continuity of operations in the event of a disruption of networks or data processing capabilities.

22. Canadian Correspondent Bank

- A bank or other member of the Canadian Payments Association engaged in business in Canada which receives the Image of a Canadian Item from the Gateway Receiving Bank for further exchange and/or payment in Canada. The Canadian Correspondent Bank also may be the Canadian Paying Bank.

23. Canadian Item

- An item denominated in U.S. or Canadian dollars eligible for exchange as an Image to a Canadian Paying Bank under Canadian Law

24. Canadian Law

- Any law, statute, rule or regulation of a Canadian governmental authority, any binding court decision or interpretation or order of a Canadian governmental authority, and the rules and standards of the Canadian Payments Association that are applicable to the Canadian Item, an Image of the Canadian Item or a person or financial institution with an interest in the Canadian Item or an Image of the Canadian Item.

25. Canadian Paper Return Item

- A paper item, created by a Canadian Paying Bank or a Canadian Correspondent Bank from a previously presented or exchanged Image of a Canadian Item, which is returned to a Gateway Receiving Bank or any Member. The term Canadian Paper Return Item includes without limitation an “Image Printout,” a “Return Replacement Document” (RRD) or a “Clearing Replacement Document” (CRD), as those three terms are defined under Canadian Law.

26. CAR / LAR

- Courtesy Amount Recognition (CAR) and Legal Amount Recognition (LAR)

- Refers to the process of using scanning devices to automatically read the numeric and written values on a check or other payment document

27. Cash Letter

- Group of negotiable items, usually checks, accompanied by a specific set of instructions for clearing

- In check processing, cash letters are prepared (physical or electronic) to be sent to a receiver based on routing number information

- May be comprised of paper checks, but most are image cash letters (ICLs) sent electronically from financial institutions or third party processors to a clearing house or the Federal Reserve for collection
SECTION FOUR – EXHIBITS

28. Check

- Written order directing a bank to pay money as instructed
- UCC 3-104 states a check is a negotiable instrument or an unconditional promise to pay; a draft payable on demand and drawn on a bank. Further sections define the check as:
  - Draft payable at a financial institution (UCC §3-106)
  - Designed to transfer the amount of money for which it is written (UCC §3-104)
  - On or after the date specified on the check (UCC §3-108)
  - To specific payee or to the bearer (UCC §3-104/3-109)
- Regulation CC (229.2) defines the check as a negotiable demand draft drawn on or payable through a bank, a Federal Reserve Bank, the US Treasury, a state government, a US postal money order, a traveler’s check and can be either an original check or a substitute check.

29. Check Conversion

- Transforming a payment initiated by paper check that has not been negotiated to an electronic payment
- Under the NACHA rules there are multiple applications that include these commonly used standard entry class (SEC) codes: ARC, POP, BOC
  - Refer to Exhibit 4 for more details

30. Check Clearing For The 21st Century Act (Check 21)

- Check 21 provides the legal equivalence of an original check with a Substitute Check
  - If a bank or its customer requires a physical document, a substitute check, also called an Image Replacement Document or IRD, can be created and is considered the legal equivalent of the original check
  - The Act only applies to the substitute check
    - Electronic exchange of images is not covered by the Act but by agreement of the parties
  - Legislation was enacted by incorporation into Regulation CC – Subpart D

31. Check Security Features

- Special design elements and security technologies included in check design in order to help protect the parties involved in the transaction from fraud such as counterfeiting, duplication of a good check, and alterations

32. Check Truncation

- To remove an original check from the forward collection or return process and send to a recipient, in lieu of such original check, a substitute check or, by agreement, information relating to the original check (including data taken from the MICR line of the original check or an electronic image of the original check)

33. Clear or Clearing

- To “clear” a check payment is to move the paper check or electronic check data from the financial institution at which it was deposited (depository bank) to the institution on which it was drawn (paying bank)
SECTION FOUR – EXHIBITS

- May involve one or more collecting banks in the process
- See also re-clear and re-presentment

34. **Clearinghouse**
- Association or place where banks exchange checks, drafts or electronic items drawn on each other, through the daily direct exchange of funds

35. **Collecting Bank**
- Any bank handling a check for forward collection, except the paying bank
  - Federal Reserve Banks are collecting banks that present items to paying banks

36. **Computer-based Testing (CBT)**
- Examinations delivered via a computer rather than a paper-based testing method
- CBT is an efficient way to provide a secure, consistent environment for certification and licensure testing
  - The NCP exam is administered annually at PSI’s proctored CBT locations

37. **Computer-based Training**
- Any course of instruction whose primary means of delivery is a computer
- CBT courses may be referred to as courseware
- May be delivered by various means:
  - Software product installed on a single computer, through a corporate or educational intranet, or over the Internet via a designated website

38. **Consumer**
- A natural person not engaged in commercial transactions

39. **Consumer Account**
- Established by a natural person primarily for personal, family, or household purposes and not for commercial use

40. **Consumer Financial Protection Bureau (CFPB)**
- Independent bureau within the Federal Reserve System created under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)
- General purpose of the CFPB is to promote fairness and transparency for mortgages, credit cards, and other consumer financial products and services
- Primary functions of the CFPB include
  - Implementing and enforcing Federal consumer financial laws
  - Reviewing business practices to ensure that financial services providers are following the law
  - Monitoring the marketplace and taking appropriate action to make sure markets work as transparently as possible
  - Establishing a toll-free consumer hotline and website for complaints and questions about consumer financial products and services
SECTION FOUR – EXHIBITS

41. Controlled Disbursement
   • A cash management service designed to maximize the funds available for investment or for trade payments
     – Product generally permits corporations to disburse funds from various operating accounts to settle trade payment, payrolls, dividends and other disbursements
     – Designed to control the flow of checks through the banking system to meet corporate needs
   • Early notification of the day’s funding requirement eliminates idle balances allowing the customer to invest surplus funds or obtain additional funds, if needed

42. Copy
   • In payments, the copy of an original check means any paper reproduction of the original check, including a paper printout of an electronic image of the original check, a photocopy of the original check or a substitute check; or
   • Any electronic reproduction of a check that a recipient has agreed to receive from the sender instead of a paper reproduction
   • See definition of “Sufficient Copy”

43. Correspondent Bank
   • Bank that conducts business transactions, accept deposits and gathers documents on behalf of other financial institutions (respondents)
     – May also be set up to conduct business in foreign countries acting as the domestic (respondent) bank’s agent abroad

44. Counterfeit Check
   • Any printed, photocopied, or other reproduction of a check or other negotiable instrument not authorized or issued by the bank or the holder of the account on which the item is drawn
   • See UCC 3-403 Unauthorized Signature for additional information

45. Customer
   • A person or entity having an account with a bank

46. Data Breach
   • An incident in which sensitive, protected or confidential data has potentially been viewed, stolen or used by an individual unauthorized to do so

47. Date of Instrument
   • Date stated on the check; May be written for a future date (postdated) or show a date that has passed (antedated)
   • If check is undated, its date is the date of its issue; See definition of “Issue of Instrument”
SECTION FOUR – EXHIBITS

48. **DDA (Demand Deposit Account)**
   - Paying funds on demand without notice of intended withdrawal, also called a checking account.

49. **DDA Posting**
   - Process of recording debits and credits to individual account balances of a DDA

50. **DDoS: Distributed Denial of Service**
   - Attack on a public website designed to slow website and prevent business or customers from accessing online services
   - Diversion used by criminals to attempt to commit fraud via stolen customer or employee credentials to initiate fraudulent wire or ACH transfers

51. **Depositary Bank**
   - First bank to which a check is transferred even though it is also the paying bank or the payee. A check deposited in an account is deemed to be transferred to the bank holding the account, even though the check is physically received and indorsed first by another bank

52. **Disaster Recovery**
   - Process an organization uses to recover access to their software, data, and/or hardware that are needed to resume the performance of normal, critical business functions after the event of either a natural disaster or a disaster caused by humans
   - Disaster Recovery Plans are generally part of a larger, more extensive practice known as Business Continuity Planning

53. **Disclosures**
   - Information required by federal or state laws that banks give their customers

54. **Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”)**
   - H.R. 4173 - Federal legislation to promote financial stability by improving accountability and transparency in the financial system, to end “too big to fail”, to protect taxpayers by ending bailouts, and to protect consumers from abusive financial services practices
   - Examples:
     - Funds availability: Section 1086 requires the first $200 (previously $100), or the total amount of the deposit if it is less than $200, of non-“next-day” checks be made available the next day
       - Amount to be adjusted for inflation every 5 years
         - Increase to be based upon the CPI as published by the Bureau of Labor Statistics, rounded to the nearest multiple of $25
     - Remittance transfers: Section 1073 requires remittance transfer providers to provide pre-payment disclosures to senders of remittance transfers along with specific error resolution procedures
SECTION FOUR – EXHIBITS

55. Draft
- Negotiable instrument that is an order to pay; See definition of “Check” and “Negotiable Instrument”

56. Drawee
- Person that is ordered in a draft to make the payment
- UCC 1-201 defines “person” as:
  - Individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government, governmental subdivision, agency, corporation, or any other legal or commercial entity

57. Drawer
- Person who signs or is identified in a draft as the person ordering payment.
  - Often used interchangeably with “maker” though UCC refers to maker as the person who signs or is identified in a note (not a draft) as a person undertaking to pay

58. E-13B Font
- Specific font type used in magnetic ink printing in USA, Canada and several other countries. It consists of ten numeric characters, 0 – 9, and four special symbols.
- ANS X9.100-20 standard identified the character set "E-13B" which can be read by certain magnetic ink character recognition devices.
- Standard also specifies the shape, dimensions, and tolerances for printed MICR characters

59. ECCHO Operating Rules and Commentary
- National set of clearing house rules available to members for private sector image exchange
- Copyrighted rules that govern electronic check transactions between two depository institutions that are both members of ECCHO
  - Rules do not govern an electronic check, electronic returned check or other transactions exchanged between non-members
- Participation and exchange under the ECCHO Operating Rules are voluntary
  - Members are not required to exchange Electronic Checks or Electronic Returned Checks; however, once a Member agrees with another Member to exchange under the Rules, those exchanges must comply with the Rules

60. ECE Institution
- Electronic Check Exchange Institution
- Term used in the ANSI X9 standards to define the institution that creates the cash letter records;
  - May or may not be the Bank of First Deposit (BOFD)
SECTION FOUR – EXHIBITS

61. Electronic check and Electronic Returned Check
   - Defined in Regulation CC as an electronic image of and electronic information derived from a paper check or a paper returned check respectively; that is
   - Sent to a receiving bank pursuant to an agreement between sender and receiving bank; and that
   - Conforms with ANSI X9.100-187 standard

62. Electronically Created Item (ECI)
   - Defined in Regulation CC as an electronic image that has all the attributes of an electronic check or electronic returned check but was created electronically and not derived from a paper check

63. Electronic funds transfer (EFT)
   - Movement of funds electronically usually through a payments system such as the ACH network or Fedwire
   - Transfer of funds initiated for the purpose of instructing or authorizing a financial institution to debit or credit an account

64. Electronic Funds Transfer Act (EFTA)
   - Federal law that defines the rights and responsibilities of individuals using EFT services
   - Implemented through Regulation E which is intended to protect individual consumers engaging in electronic fund transfers (EFTs) and remittance transfers such as:
     - transfers through automated teller machines (ATMs);
     - point-of-sale (POS) terminals;
     - automated clearinghouse (ACH) systems;
     - telephone bill-payment plans with periodic or recurring transfers
     - remote banking programs; and
     - remittance transfers

65. Electronic Check Clearing House Organization (ECCHO)
   - A service of The Clearing House Payments Company L.L.C.
     - Originally founded in 1990 by banks as a cooperative venture to encourage the use of electronics to enhance the check collection system
   - Three primary functions include:
     - Industry advocacy
     - Industry education
     - Rules for private sector image exchange
   - See definition of ECCHO Operating Rules and Commentary

66. Eligible Items
   - Items qualified or acceptable to be exchanged. See part “H: Exchange Considerations: Private Sector And Federal Reserve” of this Section Two for description of eligible items for image exchange
SECTION FOUR – EXHIBITS

67. Error Resolution

- Procedures for correcting disputed transactions to a consumer’s bank account, under Federal Reserve Regulation E
- Consumer can claim that funds were taken from its account by another person’s Unauthorized Transfer without prior consent, or a transaction was posted improperly due to a bank bookkeeping error
- Financial institution must follow the procedures as defined in Regulation E

68. Exception

- Any transaction in the form of a paper, image or electronic entry that requires further investigation before the final disposition of the entry can be decided

69. Exception Dispositioning

- Resolving the exception.

70. Exception Handling

- Working to resolve and/or further process an exception

71. Expedited Funds Availability Act

- Federal law that established maximum permissible hold periods for checks and other deposits and provided Federal Reserve Board with authority to establish return procedures for check payments
  - Regulation CC (12 CFR part 229) implements the funds-availability and disclosure provisions of the EFAA in Subpart B of the regulation
  - Check-return rules and same-day settlement rules are set forth in Subpart C of Regulation CC

72. Federal Deposit Insurance Corporation (FDIC)

- Preserves and promotes confidence in the U.S. financial system by:
  - Insuring depositors for at least $250,000 per insured bank
  - Identifying, monitoring and addressing risks to the deposit insurance funds
  - Limiting effect on the economy and financial system when a bank or thrift institution fails

73. Federal Financial Institution Examination Council (FFIEC)

- Formal interagency body that prescribes uniform principles, standards, and report forms for federal examinations to promote uniformity in the supervision of financial institutions
- Includes each of the following agencies and regulators:
  - Board of Governors of the Federal Reserve System
  - Federal Deposit Insurance Corporation (FDIC)
  - National Credit Union Administration (NCUA)
  - Office of the Comptroller of the Currency (OCC)
  - Consumer Financial Protection Bureau (CFPB)
  - State Liaison Committee (SLC) which includes representatives from the Conference of State Bank Supervisors (CSBS), the American Council of State
SECTION FOUR – EXHIBITS

Savings Supervisors (ACSSS), and the National Association of State Credit Union Supervisors (NASCUS)

74. Federal Reserve

- Federal Reserve System is the central bank of the United States founded by Congress in 1913 to provide the nation with a safe and flexible monetary and financial system and is supervised by the Board of Governors located in Washington, D.C. See definition of “Board of Governors of the Federal Reserve System”

- Federal Reserve’s duties fall into four general areas:
  - Conducting the nation’s monetary policy by influencing monetary and credit conditions in the economy
  - Supervising and regulating banking institutions to ensure safety and soundness of the nation’s banking and financial system
  - Maintaining the stability of the financial system and containing systemic risk that may arise in financial markets
  - Providing financial services to depository institutions, the U.S. government, and foreign official institutions as well as operating the nation’s payments system

75. Federal Reserve Operating Circular 3 (OC3)

- Operating Circular 3 is for the “Collection of Cash Items and Returned Checks”
  - Federal Reserve Financial Services are governed by the terms and conditions that are set forth in this and other operating circulars
  - OC3, in conjunction with Regulation J and Regulation CC, applies to the handling of all cash items the FRB’s accept for forward collection and all returned checks that are accepted for return

76. Federal Reserve Retail Payments Office (RPO)

- The Retail Payments Office (RPO) is currently headquartered at the Federal Reserve Bank of Atlanta, with additional management staff located at the Federal Reserve Banks of Boston, Cleveland, Kansas City, Minneapolis, and St. Louis

- Responsible for the Federal Reserve Banks’ ACH and Check payments products and processing

77. Finality of Payment

- An irrevocable and unconditional transfer of payment which occurs during settlement

- Finality determines the time at which the payment transaction will be regarded as fully executed
  - Gives the payee rights to the money so that the payment can no longer be revoked by the payor
  - See UCC 4-215 for additional information

78. FinCen

- Financial Crimes Enforcement Network: Bureau of the U.S. Treasury Department with a mission to:
  - Safeguard the financial system from illicit use
  - Combat money laundering
SECTION FOUR – EXHIBITS

- Promote national security through collection, analysis, and dissemination of financial intelligence and strategic use of financial authorities

79. Float

- When a bank receives a check for deposit, it provisionally credits the account of the check depositor and then later collects the funds from the bank upon which the check is drawn

- Float is tied to the timing to move, clear, and settle for checks in process of collection. Types of float may include bank float, customer float, mail float and processing float

- When check clearing is delayed, checks in the process of collection appear in the accounts of both the institutions that receive the checks for deposit and the institutions upon which the checks are drawn

- Common types of float are:
  - Bank float: Non-earning asset created through delay in collection of deposited funds
    - Correlates to calendar days elapsing (timing) between posting of customer ledger credit and bank’s receipt of usable funds
  - Customer float: Sum of dollars credited to a demand deposit account but not available for immediate withdrawal/earnings credit
    - Correlates to calendar days elapsing (timing) between posting of customer ledger credit and funds made available to customer

- Difference between total bank float and total customer float can be either positive or negative
  - See definitions for “Negative Float” and “Positive Float”

80. Forged Drawer Signature

- Altering or signing another’s signature as the drawer with the intent to defraud

- Drawer is the party instructing payment by writing or drawing a check
  - Also known as the “maker” or “writer” or “check writer”

81. Forged Indorsement

- Altering or signing another’s signature as the indorsement with the intent to defraud
  - Indorsement is a signature on the back of a negotiable instrument that legally transfers ownership to another party

82. Forward Collection

- Process by which a bank sends a check on a cash basis to a collecting bank for settlement or to the paying bank for payment

83. Fraud

- Intentional deception resulting in injury to another. There are various types of fraud and related risks across all payments systems. For additional details see part “I. Fraud and Risk” in this Guide
84. Fully Qualified
   - Under the ECCHO Rules, an item is “fully qualified” when it has full-field MICR encoding (i.e., routing transit number and, when encoded, amount field, on-us field, auxiliary on-us field and EPC field)

85. Funds availability
   - Funds available to account holder for withdrawal or other use and may include funds from an overdraft/line of credit as well as funds balances from cleared and existing deposits

86. Gateway Receiving Bank
   - The Receiving Bank that sends the Image of a Canadian Item to a Canadian Correspondent Bank

87. Good Faith
   - Honesty in fact and observance of reasonable commercial standards of fair dealing

88. Holder
   - Party in possession of a negotiable instrument, a document of title or a security (bond, note, share) that is drawn, issued, or endorsed to the party, to its order, to bearer, or in blank

89. Holder in Due Course (HIDC)
   - Holder who has possession of the instrument that:
     - Took the item in good faith
     - Took the item for value
     - Without notice the item is overdue or has been dishonored
     - Without notice signature was unauthorized or item altered
     - Without knowledge of claims against it
   - Not every holder is a holder-in-due-course

90. Image Cash Letter (ICL)
   - Digital images of paper cash letters; includes both the MICR data records and the transmitted check images
   - See part “L. Check Products” in this Guide for description of the image cash letter product

91. Image Exchange
   - Process of routing images of checks to and from financial institutions by agreement of the parties
     - Agreements needed for image exchange as applicable check law does not expressly address status of a check image
   - Image exchange rules and agreements offer provisions that exchanging financial institutions will treat check images exchanged between them as “check” and “item” for all purposes under applicable law
92. **Image File Format**
   - Initial file format for image exchange was a draft standard for trial use DSTU X9.37
   - Current standard is X9.100-187 that is supported by the Universal Companion Document (UCD) for image exchange among financial institutions
     - See “Universal Companion Document (UCD)” and “TR 47” definitions

93. **Image Quality Control**
   - Process for validating image quality to ensure image characteristics meet stated or implied needs
   - See IQA definition

94. **Image Replacement Document (IRD)**
   - Paper item substitute for an original paper check or previous IRD that conforms to the X9.100-140 standard and the Reg CC definition of a Substitute Check
   - Must contain the front and back image views
   - Must have this phrase printed as the legend on the face of the IRD:
     - “This is a LEGAL COPY of your check. You can use it the same way you would use the original check”

95. **Imperfect Image Item**
   - Electronic Image or an Electronic/Image Return that is flagged and contains an image which does not conform to industry standards for electronic image exchange or does not pass agreed upon image quality standard edits
   - See the ECCHO Operating Rules and Commentary for additional information

96. **Indemnification**
   - Security given against loss, damage or punishment; compensation for loss or injury

97. **Indemnifying Bank**
   - Regulation CC (2018) defines as a bank that:
     - Provides an indemnity under §229.34 with respect to remote deposit capture or an electronically-created item, or
     - Provides an indemnity under §229.53 with respect to a substitute check

98. **Endorsements**
   - Signature either alone or accompanied by other words for purposes of negotiating the instrument, restricting payment of the instrument, or incurring indorser’s liability on the instrument
   - UCC and Reg CC place certain responsibilities regarding endorsements on the parties handling a check
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99. **Intentional Duplicate**
   - Purposely creating or sending the same item more than once for collection and settlement
   - Typically fraud is involved

100. **IQA**
   - Image quality assurance – an image processing function that reviews electronic items prior to capture with the goal to ensure they adhere to accepted quality standards
   - Common quality defects include:
     - Too light, Too dark
     - Size
     - Streaks: Image with “dark” or “light” bands across majority of the image
     - Excessive skew – Image is not in proper alignment
     - Piggyback: Two or more documents are present and overlapped within the document image
   - Items that fail IQA may be rejected, returned or adjusted

101. **IRD**
   - See definition of Image Replacement Document

102. **Issue of Instrument**
   - First delivery of an instrument by the maker or drawer (issuer), whether to a holder or non-holder, for the purpose of giving rights on the instrument to any person
     - See UCC § 3-105 for additional information

103. **Item**
   - An instrument or promise or order to pay money handled by a bank for collection or payment
   - See also “Check” and “Negotiable Instrument” definitions in this section

104. **Item Capture**
   - MICR line is read by automated capture equipment; may also include the reading of the image

105. **Kiting**
   - Act of drawing against balances credited to uncollected checks
   - May involve the use of several accounts at different financial institutions, making deposits and writing checks against the account before the deposited checks clear, creating a “float” of money from the lag in time while checks clear and post to their respective accounts

106. **KYC - Know your customer**
   - Generally, refers to steps taken by financial institutions to establish identity of a customer to be satisfied that the source of the customer funds is legitimate
SECTION FOUR – EXHIBITS

- Should include a Customer Identification Program (CIP) as defined in Section 326 of the USA Patriot Act; and
  
  - Customer Due Diligence (CDD) and/or Enhanced Due Diligence (EDD) policies and procedures
    
    o EDD: A more detailed standard required for larger customers and transactions
    
    o Customers that pose higher money laundering or terrorist financing risks, and the related increased exposure to banks, would require additional steps to be taken by the financial institution to identify the customers and confirm that their activities and funds are legitimate

107. Legal Equivalence

- Defined as legally equal in authority

- Under Check 21, the Substitute Check is the Legal Equivalent of the original check provided the bank properly creates the substitute check and provides the warranties as defined in Regulation CC:
  
  - Accurately represents all information on the front and back of the original check as of the time the original check was truncated, and
  
  - Bears the legend:
    
    o “This is a legal copy of your check. You can use it the same way you would use the original check”

108. Local check

- A check payable by or at a local paying bank or a check payable by a nonbank payor and payable through a local paying bank

- Contrast with nonlocal check - a check payable by, through or at a nonlocal paying bank

- Both local and nonlocal checks are defined in Regulation CC and referenced in subpart B with regard to availability schedules

109. Lockbox

- Service provided by banks to companies for the receipt of payment from customers

- Under the service, the payments made by customers are directed to a special post office box instead of going to the company

- Lockbox services are generally divided into retail and wholesale products:
  
  - Retail Lockbox: For companies with high volumes of consumer-oriented payments such as utility payments, loan payments
    
    o Remittances often include a standardized payment coupon
  
  - Wholesale Lockbox: For corporate-to-corporate payments that tend to be higher dollar amounts than retail lockbox transactions
    
    o Generally, does not include a standardized payment coupon; and
    
    o Requires some manual intervention to be processed
110. **Magnetic Ink Character Recognition (MICR)**
   - Descriptive information comprised of numbers and symbols printed in magnetic ink at the bottom of a physical check that can be recognized at high speed by automated processing equipment.

111. **Magnetic ink character recognition line and MICR line**
   - As term is used in Regulation CC, means the numbers, which may include the routing number, account number, check number, check amount, and other information, that are:
     - Printed near the bottom of a check in magnetic ink in accordance with ANSI X9.13 standard for an original check and ANSI X9.100-140 for a substitute check; or
     - For subparts C and D – the information contained in a record specified for MICR line data in an electronic check or electronic returned check in accordance with ANSI X9.100–187 standard.

112. **MICR Line Format**
   - Design that applies to placement and location of magnetic ink printing on checks, drafts, and other documents intended for automated processing among depository institutions.
   - See ANSI standard X9.100-160, Parts 1 and 2 for additional detail.

113. **MICR line repair**
   - Process of correcting and/or replacing information in the MICR line.
   - Typically done prior to collecting or exchanging the item.

114. **NACHA The Electronic Payments Network**
   - National trade association for electronic payments. NACHA manages the development, administration, and governance of the ACH Network which is used for the electronic movement of money and data.

115. **NACHA Operating Rules**
   - The ACH Network is governed by the NACHA Operating Rules which set forth the rules and industry standards and procedures governing the exchange of ACH payments by depository financial institutions.

116. **NCP**
   - National Check Professional.
   - Designation earned by sitting for and passing the NCP Exam offered annually in conjunction with the National Check Payments Certification program managed by ECCHO, a service of The Clearing House Payments Company L.L.C.
   - Term also generally used to refer to the overall program.

117. **NCPC**
   - National Check Payments Certification.
   - Formal name of the nationally recognized check payments accreditation program.
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118. **Negative float**
- Negative float occurs when customer float is greater than bank float
  - Negative position from customer’s point of view
  - Bank has use of funds prior to providing availability to the customer

119. **Negotiable Instrument**
- Unconditional promise or order to pay a fixed amount of money, if it:
  - is payable to bearer or to order at the time it is issued or first comes into possession of a holder
  - is payable on demand or at a definite time; and
  - does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money
- Instrument is a “note” if it is a promise to pay and a “draft” if it is an order to pay
  - Checks are considered “drafts” – or orders to pay

120. **Noncash Item**
- Item that would otherwise be a check, except that:
  - A passbook, certificate, or other document is attached
  - Accompanied by special instructions, such as a request for special advice of payment or dishonor;
  - Consists of more than a single thickness of paper, except a check that qualifies for handling by automated check processing equipment; or
  - Has not been preprinted or post-encoded in magnetic ink with the routing number of the paying bank

121. **Nonimageable Item**
- Check that cannot be imaged or processed that has been sufficiently damaged.
- See also “Imperfect Image”

122. **OC3**
- See definition of “Federal Reserve Operating Circular 3 (OC3)”

123. **OCR**
- Optical Character Recognition: Recognition of printed or written text characters by a computer
- Involves photo-scanning the item or text character-by-character, analysis of the scanned image, and translation of the character image into character codes

124. **ODFI**
- Originating Depository Financial institution: Enters the ACH entry at the request of the Originator
  - ODFIs aggregate payments from customers and transmit them in batches at regular, predetermined intervals to an ACH Operator
SECTION FOUR – EXHIBITS

125. **OFAC**
- Office of Foreign Assets Control: Department of US Treasury that administers and enforces economic and trade sanctions based on US foreign policy and national security goals

126. **On-Us Item**
- Items deposited to the same bank on which they are drawn
  - Contrast to “transit Items” which are drawn against accounts at other financial institutions

127. **Owner**
- As term is used in check payment regulations, means the payee of the check or the bank that may be considered the agent of the owner of the check
  - Bank may purchase the item and is now the “owner” of the check
- Owners of items are not affected by agreements that may vary provisions of the regulation unless they are a party to the agreement
- See Regulation CC §229.34 Warranties and related commentary for additional detail

128. **Payor Bank**
- Bank that is the drawee of a draft;
- See definition of “Drawee”

129. **Person (as defined in Uniform Commercial Code (UCC 1-201))**
- Individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government, governmental subdivision, agency, or instrumentality, public corporation, or any other legal or commercial entity

130. **Point of Capture**
- Various locations in which items are captured prior to processing. These can include:
  - ATM
  - Branch
  - Customer (including mobile)
  - Lockbox
  - Other bank(s)
  - Third-party processor

131. **Positive Float**
- Positive float occurs when bank float is greater than customer float
  - Positive position from customer’s point of view
  - Bank has made funds available to customer prior to the bank’s collection and final settlement

132. **Positive Pay**
- Cash Management service by which banks compare a company’s record of checks issued against checks presented for payment
SECTION FOUR – EXHIBITS

- Used to deter check fraud
- Any check considered to be potentially fraudulent can be flagged for review by the issuer

- Contrast to Reverse Positive Pay: Similar service by which the bank provides information to the company
  - Company performs review comparing items to be posted against issue list
- See part “M. Check Products” in Section Two for additional information

133. **Postdated Check**
- Check or negotiable instrument payable on a future date

134. **Posting**
- The process of recording debits and credits to individual account balances.

135. **Presentment**
- Demand made by or on behalf of a person entitled to enforce an instrument to:
  - Pay instrument made to the drawee or a party obliged to pay the instrument; or
  - Accept a draft made to the drawee
- Rules subject to UCC, agreement of parties, clearing house rules and the like, presentment:
  - Must be made at place of payment if the instrument is payable at a bank
  - Made by any commercially reasonable means, including an oral, written, or electronic communication
  - Is effective when the demand for payment or acceptance is received by the person to whom presentment is made; and
  - Is effective if made to any one of two or more makers, acceptors, drawees, or other payors
- Upon demand of the person to whom presentment is made, the person making presentment must provide:
  - The instrument (check)
  - Reasonable identification and,
  - Reasonable evidence of authority to present the instrument if acting on behalf of another person
- Without dishonoring the instrument, the party to whom presentment is made may:
  - Return the instrument for lack of a necessary indorsement,
  - Refuse payment for failure of the presentment to comply with the terms of the instrument, an agreement of the parties, or other applicable law or rule
  - Treat presentment as occurring on the next business day after the day of presentment if the party to whom presentment is made established a cut-off hour (not earlier than 2 p.m.)
  - See UCC 3-417 and 4-208 for the UCC presentment warranties

136. **Proof of Deposit (POD)**
- In check processing, process by which the dollar amount of check(s) being deposited is verified as correct by comparing total checks to total amount listed for deposit
137. Proofing and Balancing Transactions
   • Process of verifying the dollar amount(s) of check(s) being deposited
   • Control process to ensure all debits equal credits; generally done as part of Day 1 processing

138. Properly Payable
   • Item is considered “properly payable” if it is authorized by the customer and in accordance with the agreement between the customer and bank
     – See UCC 4-401 for additional information

139. Qualified Returned Check
   • Returned check that is prepared for automated return to depositary bank by placing the check in a carrier envelope or placing a strip on check; and
   • Encoding the strip or envelope in magnetic ink

140. RDFI
   • Receiving Depository Financial Institution: ACH transactions are made available by the ACH Operator to the RDFI who may then debit/credit the receivers account according to the type of ACH entry
     – Individuals, businesses and other entities can all be “receivers”

141. Reconcilement
   • Process of comparing details with control totals, such as checks paid during the month and deposits made that month, with the change in bank balance at end of the month

142. Reconverting Bank
   • Bank that creates a substitute check; or
   • With respect to a substitute check that was created by a person that is not a bank, the first bank that transfers, presents, or returns that substitute check

143. Region (as defined in X9.100-140 standard)
   • Front or back area of an image replacement document (IRD)
   • Front of IRD contains the following regions:
     – Item Front Image Region: Region 1F
     – Original Check Truncation Institution Region: Region 2F
     – Creation Institution Region: Region 3F
     – Legend Region: Region 4F
     – MICR Region: Region 5F
     – Qualified MICR Region: Region 6F
     – Return Reason Region: Region 7F
     – Data Region: Region 8F
   • Back of IRD contains the following regions:
     – Item Back Image Region: Region 1B
SECTION FOUR – EXHIBITS

- Back of MICR Region: Region 2B
- Back of Optional Qualified MICR Region: Region 3B

144. **Regulation CC**
- Availability of Funds and Collection of Checks [12 CFR 229]
- Governs the availability of funds deposited in checking accounts and the collection and return of checks and substitute checks (Subpart D)

145. **Regulation E**
- Electronic Fund Transfers [12 CFR 205]
- Establishes the rights, liabilities, and responsibilities of parties in electronic funds transfers and protects consumers when they use such systems

146. **Regulation J**
- Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers through Fedwire [12 CFR 210]
- Establishes procedures, duties, and responsibilities among:
  - Federal Reserve Banks
  - Senders and payors of checks and other items
  - Senders and recipients of Fedwire funds transfers

147. **Rejected Items / Files**
- Paper or electronic payments that cannot be processed when presented for payment. There are various reasons items are rejected including mis-encoded items, stale or postdated items among others
- Files can be rejected due to out of balance conditions or incorrect formatting among others

148. **Remote Deposit Capture (RDC)**
- Service which allows a user to scan checks and transmit the scanned images to a bank for posting and clearing
  - Variety of methods for remotely capturing images including scanners and mobile devices
- Scanned checks create a digital deposit which is then transmitted (usually over an encrypted internet connection) to the financial institution

149. **Remotely Created Check (RCC)**
- Unsigned item; defined in Regulation CC as a check that is not created by the paying bank and that does not bear a signature applied, or purported to be applied, by the person on whose account the check is drawn
  - RCC generally bears a statement that the customer authorized the check or bears the customer's printed or typed name
- Can be used for example by a debtor to authorize a credit card company by telephone to create the RCC which then can enable the debtor to pay the credit card bill in a timely manner and avoid late charges
SECTION FOUR – EXHIBITS

- May be vulnerable to fraud because they do not bear a signature or other readily verifiable indication that payment has been authorized

150. **Re-presentation**

- Subsequent submission of an item that has been presented, dishonored and returned; also known as re-clear or re-deposit

- Industry rules vary on number of re-presentments that are permitted
  - ECCHO Rules allow two re-presentments for a total of three presentments:
    o Original presentment; and
    o Up to two re-presentments
  - Fed OC 3 allows one re-presentation for a total of two presentments:
    o Original presentment; and
    o One re-presentation

151. **Retention and Destruction**

- Act of keeping in storage whether physical or electronic, checks, image of checks or other items

- Retention time for the physical check varies by financial institution.

- Eliminating the checks, image of checks or other items once a retention period has expired; Items must be destroyed to prevent any further processing

152. **Retrieval**

- Act of accessing information or physical items

153. **Return**

- Item that has been dishonored by the paying bank and sent (returned) to the depositary bank

154. **Returning Bank**

- Bank (other than the paying or depositary bank) handling a returned check or notice in lieu of return. A returning bank is also a collecting bank for purposes of UCC 4–202(b)

155. **Routing Number**

- Number printed on face of a check or in a bank's indorsement

- May be in fractional or nine-digit form

- For purposes of subparts C and D, the bank-identification number contained in an electronic check or electronic returned check

  - Note: May be referred to as RT, RTN or ABA number

156. **SAR**

- Suspicious Activity Report: To be used by all US banking organizations to report known or suspected criminal violations of federal law or suspicious transactions related to money laundering activity or a violation of the Bank Secrecy Act (BSA)
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- Financial institutions are required to file a SAR to report a suspicious transaction conducted or attempted by, at, or through the institution that involves or aggregates to $5,000 or more in funds or other assets

157. SEC Code
- Standard Entry Class (SEC) Code: Three-character code that identifies the payment type and formatting requirements
- SEC Codes permit various kinds of ACH Entries to be distinguished

158. Settlement
- Process of recording the debit and credit positions of the parties involved in a transfer of fund
- Settlements can be "gross" or "net"
  - Gross settlement: Transaction is settled individually
  - Net settlement: Parties exchanging payments offset mutual obligations for delivered items resulting in only one net amount exchanged (net amount of those payments)

159. Settlement Date
- Date on which the parties to a transaction agree that settlement is to take place

160. Stale Dated Check
- Check dated more than six months ago

161. Statement Processing
- Bank process in which the banks pull items from Bulk File and create a statement for delivery to the customer; May also be online statements retrieved by the customer
- Also known as Statement Rendering

162. Substitute Check
- Paper reproduction of an original check that:
  - From Regulation CC: (1) contains an image of the front and back of the original check; (2) bears a MICR line that, except as provided under ANS X9.100-140 contains all the information appearing on the MICR line of the original check at the time that the original check was issued and any additional information that was encoded on the original check’s MICR line before an image of the original check was captured; (3) conforms in paper stock, dimension, and otherwise with ANS X9.100-140; and (4) is suitable for automated processing in the same manner as the original check

163. Sufficient Copy
- Copy of an original check that accurately represents all of the information on the front and back of the original check as of the time the original was truncated or is otherwise sufficient to determine whether or not a claim is valid
- See definition of “Copy”
SECTION FOUR – EXHIBITS

164. **Transit Item**
- Items which are drawn against accounts at other financial institutions
- Separated from on-us checks during processing in order to be sent for collection to the drawee bank via direct presentment or through a local clearing house or the Fed

165. **Transmission and Acknowledgement**
- Act of electronically sending items from one point to another, computer to computer;
- Acknowledgement is the notification of an event that has occurred; In relation to transmission there is an acknowledgement that the transmission has / has not occurred

166. **Truncating Bank**
- Bank that truncates the original check; or
- If a person other than a bank truncates the original check, the first bank that transfers, presents, or returns, in lieu of such original check, a substitute check or, by agreement with the recipient, information relating to the original check (including data taken from the MICR line of the original check or an electronic image of the original check), whether with or without the subsequent delivery of the original check

167. **Uniform Commercial Code, Code, or U.C.C.**
- As adopted in a state; the general business law adopted by a majority of the states regulating the fields of:
  - Sale of goods
  - Commercial paper, such as checks
  - Bank collections; and
  - Secured transactions in personal property

168. **Universal Companion Document (UCD)**
- Created by the banking industry to formalize an industry standard for check image exchange using the ANS X9.100-187 standard format and a compilation of industry norms
- Companion Document is developed and implemented among users of the standard to work in conjunction with the standard; a companion document does not stand on its own
- Establishes and clarifies requirements that may be more restrictive than allowed by the standard. It also may highlight specific needs for a specific exchange network or institutions
- Now defined as an X9 technical report (released in 2016)
  - TR 47 Universal Companion Document Industry Adoption of X9.100-187

169. **Virtual Capture**
- Process of capturing information through a non-physical device that only exists in computer form
170. **Warranties**
- Statement either written or implied that assertions made in completion of a contract are true

171. **WIC**
- Warranty indemnity claim adjustment; for adjustments through the Federal Reserve, a WIC iTYP may be used to identify one of several adjustments:
  - **Warranty/Indemnity Claim (WIC) Check 21**
    - For adjustments related to item where the depository institution alleges breach of a Check 21 warranty or indemnity
  - **Warranty/Indemnity Claim (WIC) Remote Deposit Capture (RDC) Item**
    - Paper Deposit Bank alleges receipt of original paper check returned unpaid because the check was previously deposited using a remote deposit capture service; various conditions must be met to file this adjustment claim
  - **Warranty/Indemnity Claim (WIC) Unauthorized Electronically Created Item (UECI)**
    - Paying institution alleges electronically created item was not authorized by the person on whose account the electronic item was created, in the amount stated on the item, or to the payee stated on the item
    - Only one of these conditions must be met to file this adjustment claim
  - **Warranty/Indemnity Claim (WIC) Unauthorized Remotely Created Check (URCC)**
    - Paying institution alleges remotely created check was not authorized in the amount stated on the check, to the payee indicated on the check, and does not bear a signature applied, or purported to be applied, by the person on whose account the check is drawn.

172. **WSUPP**
- Written Statement Under Penalty of Perjury
- Signed written statement, generally from a customer or account holder, to support a claim

173. **X9**
- Accredited Standards Committee X9, Inc. or X9 - Originally formed under American Bankers Association (1960’s)
  - Develops technical financial industry standards - X9 standards carry the ANSI designation showing they are in accord with ANSI rules and specifications for standards development and management
  - ANSI does not itself develop standards but accredits industry bodies like X9 to do so; such bodies are considered accredited standards developers
  - X9 was granted ANSI accreditation in 1984
- Evolved from a “bankers only” organization to multi-industry group that includes vendors of both banking equipment and software
- In 2001 X9 incorporated and became an independent entity

This section provides an overview of the updates to Regulation CC that were released May 2017 and took effect July 1, 2018. In addition, a final amendment for presumption of alteration released Sept 2018 and effective January 2019, is also outlined here.

1. Background
   - Prior to the adoption of the recent amendments, the regulation did not reflect the nearly complete electronification of check for forward presentment and return. The RFCs described below gathered input from the industry on how best to modernize the regulation. The 2011 and 2013 RFCs acknowledged the current electronification of check payments and aspired to incent more complete electronification for returns. It also sought to rectify some issues by creating two new indemnifications that are described in this section.
   - On May 31, 2017, final rules were published with the effective date of July 1, 2018. A final amendment adding a presumption of alteration provision was issued in September 2018 and effective January 2019.

2. Final Amendments
   - The Federal Reserve Board issued the final regulation on May 31, 2017 with updates to amend Subparts C and D to facilitate the banking industry’s on-going transition to fully-electronic check collection and return processes. Key provisions updated or added are:
     - Expeditious Return Requirements
     - Notice of Non-Payment
     - Regulation CC Coverage for Electronic Checks and Electronic Returned Checks
     - New Warranties for Electronic Checks
     - New Indemnity for Duplicate Payment from Remote Deposit Capture (RDC)
     - Definition and New Indemnity for Electronically Created Items (ECIs)
     - Same-Day Settlement Rule
     - Creation of Substitute Check for Rejected ATM Deposits
     - Elimination of Appendix D - Indorsement, Reconverting-Bank Identification and Truncation Bank Identification Standards
   - The Federal Reserve Board also requested comments on a presumption of alteration for certain disputes. That final amendment was released September 2018 with effective date January 2019.
   - Proposed revisions to Subpart B remain outstanding; not included in Final Rules.

3. General Update and Definitions
   - Federal Reserve now has one check processing site
     - All checks considered “local” for the expeditious return timeframes for Regulation CC
       o Electronic return almost always meets this return test
       o Federal Reserve was seeking how to encourage electronic returns
   - Definitions: Updates and Additions
     - Routing Number (Section 229.2(dd))
SECTION FOUR – EXHIBITS

- Revised to include bank-identification number contained in electronic check or electronic returned check
  - Indemnifying Bank (Section 229.2(uu))
    - A bank that provides an indemnity under §229.34 for remote deposit capture or for an electronically-created item
  - MICR Line (Section 229.2(vv))
    - Includes number contained in the MICR line data in accordance with the standard (X9.100-187)
      - Commentary states standards can vary the requirement for use of magnetic ink
  - Copy and Sufficient Copy (Section 229.2(bb))
    - Copy to include electronic reproduction of check that recipient has agreed to receive instead of paper

- New Electronic Definitions
  - Electronic check and electronic returned check (Section 229.2(ggg))
    - An electronic image of, and electronic information derived from, paper check or paper returned check
    - Both electronic image and electronic information must be sent
      - Can be sent separately or together
    - Sent to receiving bank pursuant to agreement between sender/receiving bank
      - Agreements are required for image exchange
    - Banks may agree to send to an intermediary who stores the information on behalf of receiving bank and then makes available
    - Establishes ANSI X9.100-187 as applicable standard or banks can agree to other standard
  - Check image and information must be “derived” from paper check
    - Use of “derived from” is meant to clarify the image must be created from a paper item
    - ECIs (defined below) are not electronic checks

4. Coverage of Electronic Check and Electronic Returned Check

- Electronic check and electronic returned check are now subject to Regulation CC, Subpart C (Section 229.30(a))
  - Treated same as paper checks for all purposes in Subpart C unless otherwise specified
  - Reference to “check” in definitions in Subpart A also includes electronic check and electronic returned check, unless otherwise specified

- Final Rules do not give bank right to send electronic check or electronic returned check absent an agreement
  - Agreements required for image exchange
    - Can be bilateral agreements
    - Clearinghouse rules (such as ECCHO Rules)
    - Federal Reserve Operating Circulars
    - Other form of interbank agreement
SECTION FOUR – EXHIBITS

- Application of Reg CC provisions to electronic checks includes:
  - Notice of nonpayment
  - Expeditious return requirements
  - Standard Reg CC Warranties

- Warranties and Indemnities
- Final Rules adopt new warranties that apply only to electronic checks and electronic returned checks (Section 229.34(a))

- Each bank that transfers or presents electronic check or electronic returned check and receives settlement or other consideration for it warrants:
  - Electronic image accurately represents all information on front and back of original check at time original check was truncated
  - Electronic information contains an accurate record of all MICR line information required for a substitute check and amount of check, and
  - “No double debit” warranty
    o Warranties worded similar to Check 21 warranties

- Warranties made by sending bank
  - For collection or presentment:
    o To transferee bank, any subsequent collecting bank, paying bank and drawer
  - For return:
    o To transferee returning bank, any subsequent returning bank, depositary bank and owner

- Warranties extend to other banks and to the drawer/owner of check
  - Consistent with substitute check warranties under Subpart D
  - Consistent with certain warranties in Subpart C (i.e. no alteration in Section 229.34(a))

- Other warranties applicable to paper check or returned check also apply to electronic checks and electronic return checks:
  - Remotely created check (RCC) warranty;
  - Settlement, amount encoding and offset warranties;
  - Returned check warranties; and
  - Notice of nonpayment warranties

- Damages for breach of new warranties cannot exceed consideration received plus interest and expenses (Section 229.34(h))
  - No indemnification for consequential damages from breach of warranty
    o Note: ECCHO Rules and Regulation. J (as referenced by Fed OC 3) provide for certain indemnifications to support the pass-back of Check 21 liability

- No warranty application to ECI as it is not defined as an “electronic check”

- Check image warranties may be varied by agreement, but variation limited to persons bound by agreement (Section 229.37)
5. **Expeditious Return Rule**

   - Requires all returned checks, both paper and electronic, to satisfy modified version of current “two-day test” for expeditious return (Section 229.31(b))
     - Paper and electronic checks must be returned to depositary bank (i.e., BOFD) such that check would normally be received by depositary bank no later than 2:00 p.m. (depositary bank local time) on second business day following banking day on which check was presented to paying bank
       - Previously this timing was 4:00 p.m.
     - Commentary: In determining whether an electronic returned check would “normally” reach a depositary bank within the specified deadline:
       - Paying bank may rely on returning bank’s return deadlines and availability schedules for electronic returned checks
   - Eliminates current four (4) day and forward collection return tests
   - Return may be sent to depositary bank or returning bank agreeing to handle return
   - Return reason must be maintained on any subsequent substitute check
   - Paying bank not responsible for unforeseeable delays of return such as communication failures
   - Final Rules adopt similar expeditious return requirement for returning banks
   - No liability for failure of expeditious return for certain arrangements (Section 229.33(a))
     - Paying or returning bank may be liable to depositary bank for failing to meet requirement only if depositary bank has arrangements for return of checks to depositary bank electronically by “commercially reasonable means”
       - Does not require direct return arrangement with paying bank
         - Depositary bank arrangement can be through one or more returning banks
       - Burden of proof on depositary bank if late claim is asserted
         - Fact specific determination
     - Liability approach encourages depositary bank to accept electronic returned checks
   - Exceptions to expeditious return obligation (Section 229.31(d) and 229.32(c))
     - Check deposited in depositary bank not subject to Subpart B
       - Depositary bank with only time or savings accounts or credit card accounts
     - Paying/returning bank: When unable to identify depositary bank of check
       - New Commentary: If no electronic addenda record, paying bank must examine image to attempt to identify depositary bank
     - Returning bank: When it handles a misrouted returned check

6. **Notice of Non-Payment**

   - Notice requirement applies to electronic checks as well as paper checks (Section 229.31(c))
     - Final Rules address the following changes:
SECTION FOUR – EXHIBITS

- Increase dollar threshold to $5,000 (previously $2,500)
- Time for receipt by depositary bank 2:00 p.m. (previously 4:00 p.m.)
  depositary bank local time
- Delivery standard to parallel new expeditious return standard
- New exception for paying bank from notice requirement if depositary bank is unidentifiable
- Change in content requirements for notice – see below
  - Final Rules maintain current obligation on paying bank to use indicator to note information of “uncertain” accuracy

- Content for Notice of Non-Payment
  - To the extent available to paying bank, the Final Rules require the following:

<table>
<thead>
<tr>
<th>Current Requirement</th>
<th>Final Rule Requirement</th>
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<tbody>
<tr>
<td><strong>No Change</strong></td>
<td></td>
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<tr>
<td>Other information that may be useful – Depositary name and routing number</td>
<td>Bank name and routing number associated with indorsement of depositary bank</td>
</tr>
<tr>
<td>Trace number associated with indorsement of depositary bank</td>
<td>Trace or sequence number associated with indorsement of depositary bank</td>
</tr>
<tr>
<td>Name of Payee(s)</td>
<td>Name of Payee(s)</td>
</tr>
<tr>
<td>Amount</td>
<td>Amount</td>
</tr>
<tr>
<td>Date of indorsement of depositary bank</td>
<td>Date of indorsement of depositary bank</td>
</tr>
<tr>
<td>Reason for nonpayment</td>
<td>Reason for nonpayment</td>
</tr>
<tr>
<td><strong>No Longer Required</strong></td>
<td></td>
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<tr>
<td>Name and routing number of paying bank</td>
<td></td>
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<tr>
<td>Account number of customer of depositary bank</td>
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<tr>
<td>Bank name or number of depositary bank from indorsement</td>
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</tbody>
</table>

7. Notice in Lieu of Return
   - Final Rules retain Notice in Lieu of Return (Section 229.31(f))
     - Change in content – see above
     - New Commentary: Notice in lieu of return is permitted only when a bank does not have sufficient electronic information/image to create a substitute check

8. Electronically Created Item (ECI)
   - Electronic image that has all attributes of electronic check or electronic returned check but was created electronically and not derived from paper check (Section 229.2(hhh))
   - Does not meet definition of electronic check; ECI cannot be used to create a substitute check that is legal equivalent
SECTION FOUR – EXHIBITS

- Commentary provides ECI examples:
  - Corporate customer electronically creates an image that looks like an image of corporate customer’s paper checks and emails the image to the payee
  - Consumer uses a smart-phone application to electronically create and send check image to payee
  - Consumer provides his/her account information to utility which then uses information to create and deposit ECI with its bank to obtain consumer payment

- ECI Indemnity (Section 229.34(g))
  - Covers losses caused by the following:
    o ECI not derived from paper check;
      - Could include Reg E losses incurred by paying bank
    o ECI not authorized by account holder; or
    o Subsequent bank pays an item that has already been paid
  - Indemnity shifts losses to depositary bank
  - Depositary bank may allocate liability to depositor in its customer agreement
  - Indemnity does not extend to drawer or owner of the check
  - ECI is not an “electronic check” under Final Rules
    o Not subject to other provisions of Reg CC (such as expeditious return or warranty provisions)

9. Remote Deposit Capture (RDC) Section 229.34(f)

- Indemnity to protect a second depositary bank that received deposit of paper check that was returned unpaid because check previously deposited at another depositary bank using RDC service
- Indemnity provided by first depositary bank that:
  - Is the truncating bank – because it accepts deposit of electronic image or electronic information related to original check;
  - Does not receive original check;
  - Receives settlement or other consideration for electronic check or substitute check related to original check; and
  - Does not receive return of check unpaid
- Depositary bank indemnifies second depositary bank that accepts original check for deposit, for losses incurred by second depositary bank if loss is due to check having already been paid
  - Scope of damages limited to consideration received plus expenses / attorney’s fees
  - Comparative negligence defense available
- Depositary bank does not make indemnity if original check bore restrictive indorsement inconsistent with means of deposit
  - Example: “For mobile deposit at [name of first depositary bank] Only”
- First depositary bank’s potential liability arises when it permits customer to truncate check and deposit image
  - Customer retains original check and may intentionally or mistakenly deposit paper check in another bank
SECTION FOUR – EXHIBITS

- Indemnity permits depositary bank that accepts original paper check to make claim against depositary bank that permitted customer to truncate
  - Claim can be made to any truncating bank, even if multiple truncating banks
  - Claim only exists if check returned to bank that accepted original check due to the fact check already paid
  - Allows truncating bank to allocate loss arising under indemnity to its depositing customer by agreement

10. Variation by Agreement

- Section 229.37 provides for variation of Subpart C by agreement
  - Minor changes to commentary
  - Variation by clearing house rules binds banks agreeing to those clearing house rules, but not other persons interested in item (e.g., drawer or owner)
  - No agreement can disclaim responsibility of bank for its own lack of good faith or failure to exercise ordinary care
  - Variation by agreement important to allow industry to develop processes and operating rules

11. Indorsements (Section 229.35)

- Appendix D – Indorsement, Reconvert-Bank Identification and Truncation Bank Identification Standards is eliminated
- Regulation now refers to X9 industry standards for indorsements:
  - Check Endorsements – X9.100-111
  - Substitute check – X9.100-140; and
  - Electronic check X9.100-187

12. Presumption of Alteration (Section § 229.38)

- Final amendment adopted September 2018, effective January 2019 [§229.38 Liability (i)]
- Presumption addresses situations where there is a dispute as to whether a check has been altered or was issued with an unauthorized signature, and the original paper check is not available for inspection
  - Regulation CC adopted a presumption of alteration for disputes between banks
  - Presumption may be overcome by preponderance of evidence that check was forged or is as issued by drawer
  - Presumption does not apply if original check is made available to all parties

13. Other Issues

- Presentment/Return of Electronic Checks (Section 229.36(a))
  - Terms for presentment and return of electronic checks determined by agreement of exchanging banks with terms that may include:
    o Electronic address for sending electronic checks
    o When presentment occurs
  - Receiving bank may require separation of return and forward items
SECTION FOUR – EXHIBITS

- **Writings – Section 229.30(b)**
  - Bank may, by agreement, send in electronic form information and notices otherwise required under Reg CC to be in “writing”
    - Example: Notice of Non-payment

- **Definition of RCC (Section 229.2 (fff))**
  - Requested comment in 2014 to narrow scope of definition to include only checks created by payee (or payee’s agent)
    - No change in Final Rules

- **Refer to Maker – Commentary Section 229.31(e)**
  - In 2011 Fed proposed elimination of this return reason, stating it was not a reason but an instruction
  - Final Rules recognize this return reason can be appropriate in some cases such as when:
    - Drawer has positive pay arrangement and instructs bank to return the check
  - Not appropriate for the following:
    - Check is being returned due to paying bank having already paid item (duplicate)
    - Check has been altered or is unauthorized

- **Same Day Settlement (Section 229.36(d))**
  - Retains current SDS rule and clarifies only applies to paper presentment
  - Settlement for presentment of electronic checks governed by agreement of parties

- **Rejected Deposit (Sections 229.52(a)(2) and 229.53(a)(2))**
  - Bank that rejects check submitted for deposit (i.e. ATM) may send customer substitute check
    - Bank makes Check 21 warranties and indemnification, regardless of whether bank received consideration for substitute check

- **Payable Through Checks – Current Section 229.36(e)**
  - Final Rule deletes requirements regarding information to be printed on face of payable through checks
    - Not needed with single check processing region
SECTION FOUR – EXHIBITS

EXHIBIT 17: FFIEC – OVERVIEW OF SELECTED GUIDANCE

This exhibit provides details on key FFIEC guidance handbooks and booklets that are references for the NCP exam. The tables on the following pages list the selected documents, areas of focus for study and a summary description for each document.

This summary is provided for general educational purposes only and should not be relied upon by any person as legal advice. The following tables do not provide a complete description of all FFIEC Guidance that may impact check payments or any particular check exchange.
### FFIEC Guidance Manual or Booklet

<table>
<thead>
<tr>
<th>Focus for Study</th>
<th>Description</th>
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| **Bank Secrecy Act/Anti-Money Laundering Examination manual 2010** | FFIEC Bank Secrecy Act (BSA)/Anti-Money Laundering (AML) Examination Manual provides guidance to examiners for carrying out BSA/AML and Office of Foreign Assets Control (OFAC) examinations. An effective BSA/AML compliance program requires sound risk management; therefore, the manual also provides guidance on identifying and controlling risks associated with money laundering and terrorist financing. The manual contains an overview of:  
  - BSA/AML compliance program requirements  
  - BSA/AML risks and risk management expectations  
  - Industry sound practices, and  
  - Examination procedures  
  
  BSA was designed to help identify the source, volume, and movement of currency and other monetary instruments transported or transmitted into or out of the United States or deposited in financial institutions. It seeks to achieve that objective by requiring individuals, banks, and other financial institutions to file currency reports with the U.S. Treasury Dept., properly identify persons conducting transactions, and maintain a paper trail by keeping appropriate records of financial transactions. These records enable law enforcement and regulatory agencies to pursue investigations of criminal, tax, and regulatory violations, if warranted, and provide evidence useful in prosecuting money laundering and other financial crimes.  
  
  The Money Laundering Control Act of 1986 augmented the BSA’s effectiveness by imposing criminal liability on a person or financial institution that knowingly assists in the laundering of money, or that structures transactions to avoid reporting them.  
  
  In April 1996, a Suspicious Activity Report (SAR) was developed to be used by all banking organizations in the United States. A banking organization is required to file a SAR whenever it detects a known or suspected criminal violation of federal law or a suspicious transaction related to money laundering activity or a violation of the BSA. |
| **Authentication in Internet Banking Environment Oct 2005** | Guidance focuses on risk management controls to authenticate the identity of customers accessing internet-based financial services. Addresses why financial institutions should conduct risk-based assessments, evaluate customer awareness programs, and develop security measures to authenticate customers that access internet-based financial services. Applies to both retail and commercial customers and should be used when evaluating and |
# National Check Payments Certification

## SECTION FOUR – EXHIBITS

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<tr>
<th>FFIEC Guidance Manual or Booklet</th>
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<tbody>
<tr>
<td>• What is multi-factor authentication?</td>
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<tr>
<td>• What is a type of account fraud?</td>
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<tr>
<td>• What is identity theft?</td>
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<tr>
<td>Implementing authentication systems and practices, whether for internal services or those from a service provider. Authentication techniques should be appropriate to the risks associated with those products and services. Where risk assessments indicate single-factor authentication to be inadequate, should implement:</td>
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<tr>
<td>− Multifactor authentication,</td>
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<tr>
<td>− Layered security, or</td>
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<tr>
<td>− Other controls to mitigate risks</td>
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<table>
<thead>
<tr>
<th>Supplement to Authentication in an Internet Banking environment June 2011</th>
<th>What is customer authentication?</th>
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<tbody>
<tr>
<td>• What is layered security?</td>
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<tr>
<td>• What is dual authentication?</td>
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<tr>
<td>This 2011 supplement reinforces the guidance for a risk management framework and provides updates on customer authentication, layered security, or other controls for the online environment. Perform periodic risk assessments and adjust customer authentication, layered security, and other controls as appropriate in response to identified risks. Virtually every authentication technique can be compromised, and financial institutions should not rely solely on any single control for authorizing high risk transactions, but rather institute a system of layered security.</td>
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<tr>
<td><strong>Layered security:</strong> Characterized by different controls at different points in a transaction process so that a weakness in one control is generally compensated for by the strength of a different control. It can substantially strengthen the overall security of internet-based services and be effective in protecting sensitive customer information, preventing identity theft, and reducing account takeovers. Financial institutions should implement a layered approach to security for high risk internet-based systems. Effective controls in a layered security program include, but are not limited to:</td>
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<td>− Fraud detection and monitoring systems that include consideration of customer history and behavior and enable a timely and effective institution response;</td>
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<tr>
<td>− Use of dual customer authorization through different access devices;</td>
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<tr>
<td>− Use of out-of-band verification for transactions;</td>
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<tr>
<td>− Use of “positive pay,” debit blocks, other techniques to appropriately limit the transactional use of the account</td>
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<tr>
<th>Information Security booklet Sep 2016</th>
<th>What are the four key steps in establishing and supporting an</th>
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<tr>
<td>A financial institution must protect the creation, collection, storage, use, transmission, and disposal of sensitive information, including the protection of hardware and infrastructure used to store and transmit such information. The Information Security booklet aids in the assessment of security risks to a financial institution’s information systems. Commonly</td>
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### FFIEC Guidance Manual or Booklet

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| effective operational risk management program? | accepted objectives of these systems include the confidentiality, integrity, and availability of information and are essential to the overall safety and soundness of an institution. Potential adverse effects can arise from the following:  
  - Disclosure of information to unauthorized individuals.
  - Unavailability or degradation of services.
  - Misappropriation or theft of information or services.
  - Modification or destruction of systems or information.
  - Records that are not timely, accurate, complete, or consistent. Information security programs should be commensurate with the institution’s operational complexities and should have strong board and senior management support, promote integration of security activities and controls throughout the institution’s business processes, and establish clear accountability for carrying out security responsibilities. An effective information security program includes the following:  
  - Risk identification
  - Risk measurement
  - Risk mitigation
  - Risk monitoring and reporting |

### Operations booklet Jul 2004

<table>
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| What are the responsibilities of senior management regarding Operational Risk Management? | Guidance covers the risks and expected controls in IT operations across the institution, emphasizes sound processes and staff training. This booklet is applicable to complex core operations at centralized data center locations, distributed operations at lines of business, support functions, and affiliates under the enterprise umbrella as well as smaller or less complex technology operations at community banks. The financial institution's board of directors and senior management are responsible for overseeing a safe and sound IT operating environment that supports the institution's goals and objectives. Applies to centralized and decentralized operations centers, including those located within lines of business; functional operations; affiliates under the enterprise umbrella; and outsourcing arrangements. The general steps to establish and support an appropriate control environment include: risk identification, risk assessment, risk management, and ongoing risk monitoring and reporting. Key elements of these responsibilities include:  
  - Implementing IT operational organization structure to support the business activities of the institution; |
### FFIEC Guidance Manual or Booklet

#### Focus for Study

- Documenting the systems in place, and understanding how each supports associated business processes;
- Creating a physically and logically secure operating environment;
- Providing for operational continuity and resiliency;
- Providing for adequate staffing and personnel selection, succession, and training;
- Using qualified consultants and external auditors, when necessary

In general, Operations Risk Management includes identifying the risks and developing and maintaining:

- Inventory of all computing hardware and all computing software (operating systems, applications, and back office and environmental applications);
- Network topologies or diagrams that detail internal/external connectivity of voice and data communication networks;
- Data flow and business process diagrams that depict operational interdependencies;
- Comprehensive view of how technology operations support the strategic business goals of the institution

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### Retail Payments Systems

**April 2016**

- What are the six primary risk categories associated with retail payments systems?

Provides guidance to examiners, financial institutions, and technology service providers on identifying and controlling risks associated with retail payment systems and related banking activities. Financial institutions accept, collect, and process a variety of payment instruments and participate in clearing and settlement systems. However, independent third parties are increasingly involved in this process, introducing new risks that affect the security of financial institutions. The Federal Reserve Banks also compete with numerous financial institutions and private sector firms in providing various services in support of retail payments. Management of retail payments risk is increasingly difficult and requires diligent oversight. Mature payment systems are better understood, whereas emerging payment systems require a closer look to better understand the risks and associated controls. New guidance is offered for these various payment types. Examination guidance for Retail Payment Systems is provided in three sections:

- Retail Payment Systems Overview
  - Presents an overview of retail payment systems, grouping retail payment instruments in various categories, including: checks, card-based electronic
### SECTION FOUR – EXHIBITS

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<tr>
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<td>payments, and other electronic payments, such as person-to-person (P2P), electronic benefits transfer (EBT), and ACH.</td>
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</tbody>
</table>
|                                  |                 | - Payment Instruments, Clearing, and Settlement  
  |                                  | o Describes the retail payment system instruments typically offered by financial institutions and the roles of various payment system participants, including third parties. |
|                                  |                 | - Retail Payment Systems Risk Management  
  |                                  | o Describes the risks associated with various retail payment systems and instruments, using the regulatory risk categories:  
  |                                  |   ▪ Strategic  
  |                                  |   ▪ Credit  
  |                                  |   ▪ Reputation  
  |                                  |   ▪ Operational/transaction  
  |                                  |   ▪ Liquidity and Settlement and  
  |                                  |   ▪ Legal/compliance risk |
| Supervisory Guidance for Remote Deposit Capture Jan 2009 | • What is remote deposit capture?  
  |                                  | • What are the three areas of risk management to be considered before offering RDC?  
  |                                  | • Why are strong customer and/or vendor contracts needed for RDC? | Guidance addresses the RDC risk management process focusing on RDC deployed at a customer location. Remote Deposit Capture (RDC) is a deposit transaction delivery system that allows a financial institution to receive digital information from deposit documents captured at remote locations that may be branches, ATMs, domestic and foreign correspondents, or locations owned or controlled by commercial or retail customers. RDC enables customers to deposit items electronically from remote locations and introduces additional risks. Before offering RDC, consider three areas of risk management – assessment, mitigation and controls, and measuring and monitoring:  
  |                                  | **Risk Management: Assessment**  
  |                                  |   - **Legal and Compliance Risks:** Identify and assess exposure to legal and compliance risks related to RDC. Legal risk exposures may be related to the controls over the process used for image capture or image exchange and the institution’s arrangements and contracts for clearing and settling checks. When a financial institution sends the deposited items to another institution for collection or presentment, consider the risks it takes under Reg CC, Reg J, applicable state laws, or any agreements or clearinghouse rules that may also apply. |
### FFIEC Guidance Manual or Booklet

### Focus for Study

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<td><strong>Operational Risks:</strong> Understand operational risks and ensure that appropriate policies, procedures, and other controls are in place to mitigate them, including physical and logical access controls over RDC systems, original deposit items at customer locations, electronic files, and retained nonpublic personal information (NPI). Assess the risks associated with how/where NPI is captured, transmitted, retained, and destroyed.</td>
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<td><strong>Risk Management: Mitigation and Controls</strong></td>
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<td>- Implement appropriate risk management policies based on risk tolerance levels and create well-designed contracts that meet the institution’s risk management needs.</td>
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<td>- <strong>Customer Due Diligence and Suitability:</strong> Establish appropriate guidelines to qualify customers for this service</td>
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<td>- <strong>Vendor Due Diligence and Suitability:</strong> Ensure implementation of sound vendor management processes as described in the Outsourcing Technology Services Booklet of the FFIEC IT Examination Handbook</td>
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<td>- <strong>RDC Training for Customers:</strong> Ensure customer understand their role in managing risks and monitoring for processing errors or unauthorized activity</td>
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<td>- <strong>Contracts and Agreements:</strong> Strong, well-constructed contracts and customer agreements are critical in mitigating the financial institution’s risks and should be developed by legal counsel</td>
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<td><strong>Business Continuity:</strong> Ensure the financial institution’s ability to recover and resume RDC operations to meet customer service requirements when an unexpected disruption occurs.</td>
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<td><strong>Risk Management: Measuring and Monitoring</strong></td>
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<td>- Develop and implement risk measuring and monitoring systems for effective oversight of RDC activities. Ensure customers have implemented operational/risk monitoring processes; regularly review periodic reporting</td>
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SECTION FOUR – EXHIBITS

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