Fed Proposed Changes to Regulation CC and issued a request for comment (RFC) in December 2013. The process of updating Reg CC began early in 2011. The 2013 RFC built upon learnings from the 2011 RFC. This At a Glance document is a synopsis of the major components of the RFC and the Working Group’s comment letter back to the Fed.

Who is the Working Group?
As a key advocate of the check payment system, ECCHO facilitated more than 20 hours of calls among over 100 financial services organizations including ABA, ICBA, FSR, TCH, banks, credit unions, processors, bankers’ banks, industry consultants, vendors, and ECCHO’s legal counsel. Collectively, these organizations made up the Working Group. These calls worked through a detailed analysis of all proposed changes. All participants were encouraged to ask questions and expressed their opinions about issues in the RFC. The result was a better understanding of the proposal and its potential effect on the industry and individual players.

Why Update Reg CC?
While the check industry has changed much since the implementation of image technology, Reg CC has remained the same. The existing regulation does not reflect the nearly complete electronification of check forward presentment and returns.

The Fed issued the RFC in order to get input from the industry on how best to modernize the regulation. The RFC acknowledged current electronification and aspired to incent complete electronification for returns. It also sought to rectify some issues by creating new indemnifications. Recap of existing Reg CC:

- Subpart A: Definitions
- Subpart B: Funds Availability Provisions (not a part of this update; under co-jurisdiction with Fed and CFPB)
- Subpart C: Collections and Return of Checks which established expeditious return requirement (All returns are now local for expeditious return window)
- Subpart D: Implements Check 21

Proposed New Reg CC Concepts: Sneak Peek
Following are highlights of Fed proposed changes to Reg CC in the 2013 RFC:

- New definitions for electronic check and electronic returned check, would be subject to Subpart C
- New Check 21-like warranties and existing Reg CC warranties would extend to electronic checks and electronic returned checks
- Two alternatives for returns: 1) no expeditious return requirement and 2) conditional expeditious return requirement
- Two new indemnifications: 1) Truncating Bank for RDC and 2) Electronic Image or Electronic Information Not from Paper check for EPOs
- Other issues for comment: 1) SDS, 2) Definition of RCC, 3) Presumption of Altered or Forged, 4) “Refer to Maker”, 5) X9 Standards, 6) Rejected Deposit

Unchanging Overarching Concept - Exchange of electronic checks or electronic returned checks requires agreement (e.g., bilateral, under ECCHO rules or Fed OC3).

Analysis of Proposed Changes: Electronic Returns
The majority of Working Group calls focused on understanding the two alternatives for returns because the result will have a significant impact on how the check industry operates for decades. Currently, electronic returns almost always meet expeditious return requirements, so the RFC focused on a suitable solution for paper returns. Fed Alternative 1 would not require expeditious return and Fed Alternative 2 would have a conditional expeditious return requirement.

Following is a brief description of each return alternative (dark blue banner) and the corresponding Working Group comments (light blue banner). RFC summaries and Working Group comments are high level. For more detail, refer to the original documents--links below.
### Reg CC RFC & Working Group Comments on Return Alternatives

**Fed RFC Returns Alternative 1: No Expeditious Return Requirement**

Major points in Return Alternative 1 include:

- Electronic return would not be mandatory
- Would eliminate expeditious return requirement for both paying bank and returning bank regardless of whether electronic or paper
- Paying bank would be subject to UCC midnight return deadline, and returning bank subject to UCC requirement of handling return with ordinary care
- Notice of non-payment would be required for any check returned by paying bank in paper form, regardless of dollar amount:
  - Notice must be received by depositary bank by 2 pm local time on the second business day after presentment—potential change from current Reg CC delivery time of 4 pm

**Working Group Comments: Alternative 1**

Working Group does not support the adoption of Alternative 1 due to the following concerns:

- Would not require expeditious return
- Would not require electronic returns
- Would not impose sufficient incentives on BOFDs to sign up for electronic returns
- Could result in slower returns
- Would not protect electronic return-enabled BOFD—may receive non-expeditious return and no notice of non-payment—when returning bank drops return to paper
- Expeditious return test should not rely on notices once all returns are electronic

(End of Alternative 1 Comments)

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**Fed RFC Returns Alternative 2: Conditional Expeditious Return**

Major points in Return Alternative 2 include:

- Electronic return would not be mandatory
- Expeditious return requirements would apply in scenarios where an electronic path has been established directly/indirectly by agreement between the paying bank and BOFD—regardless of whether the path is taken or not
- Even if paper/substitute check is sent, as long as there is a path of electronic agreements, then expeditious return would be required:
  - 2-day expeditious return test would apply
  - Depositary bank must receive by 2 pm local
  - 4-day and forward collection tests eliminated

**Working Group Comments: Alternative 2**

Working Group does not support Alternative 2 as proposed. Alternative 2 comments:

- Would encourage those with some existing electronic returns capabilities to receive all returns electronically
- Would not incent BOFDs with no electronic returns arrangements to sign up for electronic returns since risk is low for those with few returns
- Would be operationally difficult for a paying bank to know whether it has electronic return arrangement with a particular BOFD via one of its returning banks
- Would be difficult to determine responsibilities for expeditious returns due to operational complexities
- BOFD with multiple electronic returns channels would be exposed to risk of non-expeditious returns
- Return timeframes would be unpredictable for BOFD

(Continued on Page 3)
Recommendations from the Working Group:
The Working Group proposed additions for Alternative 2:

1) an additional return test option, and
2) a notice of nonpayment for high dollar items.

1) Additional Return Test Option:

- One problem with the proposed plan for expeditious return is that it would be difficult, in some cases, to know whether there is an electronic return path or not. Instead of trying to figure out if there is an electronic return option, propose that Paying bank could satisfy its expeditious return obligation by sending an electronic return to a bank that Paying bank would use for forward presentment.

- Returning bank could satisfy its expeditious return obligation by sending an electronic or paper return directly to the BOFD or to a bank it would use for forward presentment.

- Proposed adding text to 229.31 and 229.32 to define the above tests and to the commentary to explain details.

2) Notice of Nonpayment for High Dollar Items:

- Proposed that Paying bank send a notice of nonpayment on high dollar items (e.g., $10,000) unless it sends the return expeditiously (within 2-day period).

Further Recommendations from the Working Group:

- The remaining 2 percent of paper returns should be electronified in the near future. The Working Group did not believe that the two alternatives in the proposal would incent full movement to electronic returns. Working Group suggested Fed sunset paper returns within 2-3 years after issuing final rule.

- After the sunsetting of paper checks, Reg CC would maintain an expeditious return requirement for the electronic return process.

- Suggested including commentary to support the use of all electronic returns methods, including non-conventional methods (e.g., PDF file).

- While Fed has taken a market-driven approach in the past, the Working Group believed that due to the fundamental change in the check exchange environment, sunsetting paper returns is the most effective and reasonable way to achieve 100% electronification.
## Two New Indemnities Proposed

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<th><strong>Truncating Bank Indemnity for RDC</strong></th>
<th><strong>Fed RFC</strong></th>
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<td>Proposed new indemnity 229.34(g): <em>Would indemnify another depositary bank that accepts the original check for deposit for that bank’s losses due to the check having already been paid. This indemnity would allow a depositary bank that accepts deposit of an original check to recover directly from a bank that permitted its customer to deposit the check through remote deposit capture.</em></td>
<td><em>The Working Group supported the Fed’s initiative to provide a new indemnity between the truncating BOFD and the second BOFD that accepts the original paper check for deposit. Although there is no single solution to solve all of the various duplicate scenarios, this indemnity would be a step in the right direction. It provides the second BOFD—the one that accepted the physical item for deposit—with the ability to file a claim against the first BOFD whose RDC customer failed to control the paper and erroneously or fraudulently redeposited the item.</em></td>
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<td>The Working Group recommended that the Fed impose limitations on when this indemnity is available to the second BOFD: 1) must be a holder in due course, 2) depositor must not be same person who deposited at truncating bank, 3) indemnity should not be available if there is evidence of the initial deposit. Due care must be exercised when accepting check deposits. Recommended that this indemnity not be applicable to counterfeit or altered items and that final rule clarify that second BOFD can make claim to truncating BOFD without first seeking to charge item to its depositing customer’s account. Working Group recommended a time period of within 30 calendar days for making this claim. The Working Group did not believe comparative negligence would be appropriate for duplication warranty claims.</td>
<td><em>Working Group generally supported this indemnity which protects the paying bank from a loss which occurs from the exchange of an EPO rather than an image created from a paper check. This indemnity reasonably addresses the risk of EPOs and enables innovation. Working Group would not support any approach that prohibits exchange of EPOs in the future. Recommended that the Fed establish an indemnity/warranty combination for the final rule, similar to approach in 229.52 and 229.53.</em></td>
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<th><strong>Electronic Image or Electronic Information Not from Paper Indemnity for EPOs</strong></th>
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<td>Proposed new indemnity 229.34(b): <em>Would provide that a bank that transfers an electronic image or electronic information that is not derived from a paper check would indemnify the transferee bank, any subsequent collecting bank, the paying bank, and any subsequent returning bank against any loss, claim, or damage that results from the fact that the image or information was not derived from a paper check.</em></td>
<td><em>The Working Group generally supported this indemnity which protects the paying bank from a loss which occurs from the exchange of an EPO rather than an image created from a paper check. This indemnity reasonably addresses the risk of EPOs and enables innovation. Working Group would not support any approach that prohibits exchange of EPOs in the future. Recommended that the Fed establish an indemnity/warranty combination for the final rule, similar to approach in 229.52 and 229.53.</em></td>
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### Other Issues for Comment

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<td><strong>Same Day Settlement (SDS)</strong></td>
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<td>SDS rule was established initially to reduce the competitive disparity between the Federal Reserve and financial institutions, as well as reduce barriers to presentment. The 2011 proposal addressed certain aspects of an electronic SDS but the latest proposal retained SDS rule only for paper presentment. The 2013 proposal sought guidance on keeping or eliminating paper SDS, and whether to develop an electronic SDS. Settlement or presentment of electronic checks would continue to be governed by agreement among the parties. The Working Group spent a good deal of time considering SDS. Everyone supported the eventual elimination of paper SDS to reflect the move to electronic clearing, and so that dual systems do not have to be maintained. There was some concern that keeping the paper system indefinitely would allow certain parties to game the system by insisting on paper SDS. Therefore the group supported the elimination of the paper system once the Fed has either: 1) established an electronic SDS system or 2) implemented a policy/rule that resolves the ongoing competitive concerns that paper SDS was intended to address. Fed has competitive advantage because: 1) it can present items to any paying bank without paying a presentment fee, and 2) it can obtain same day settlement for the presented items from the paying bank’s account at the Federal Reserve. There was no clear consensus on how best to move forward with electronic SDS. However, the real issue is how to address the Fed’s competitive advantage.</td>
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<td><strong>Narrowing the Definition of Remotely Created Check (RCC)</strong></td>
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<td>The current definition of RCC is <em>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</em>. Comments requested on whether to narrow the scope of RCC definition to only checks created by payee or payee’s agent. 2011 commenters suggested distinguishing between RCCs created by payee/payee’s agent and a third party (e.g., bill payment service). The Working Group agreed that the definition of remotely created checks is overly broad and recommended that the Fed define an RCC as <em>an item that does not contain the signature of the drawer and was created by the payee or the agent or service provider of the payee</em>. This definition would exclude items created by the drawer but left unsigned. This definition would provide greater clarity around customer authorization and the type of items that are subject to the warranty and would address the types of items that are generally the source of consumer disputes regarding authorization. There are frequent cases where an RCC is created by a bill payment company or a paying bank, acting at the instruction of the account holding customer, to make a payment to a payee. In these cases the payee and the BOFD have no control over or involvement in the creation of the RCC, have not requested an RCC for payment, and may not even realize that the received item is an RCC. Therefore, in these cases, the BOFD should not be required to make the warranty of customer authorization for the RCC under Section 229.34. This requested change would make the paying bank responsible for the payment and the determination of authorization for those items that are created by the account holding customer and the agent and service providers of the account holding customer. The paying bank would be in the best position to monitor its customer’s authorization of these items.</td>
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<td><strong>Rejected Deposit</strong></td>
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<td>There are situations in which a check is deposited but then rejected. (e.g., ATM check image deposit deemed unusable so substitute check is issued to the customer). The proposal specified that a bank that rejects a check submitted for deposit and sends customer a substitute check, makes Check 21 warranties and provides indemnification, regardless of whether bank received consideration for the substitute check. The Working Group supported the amendment to Section 229.52 to provide that a depository bank that rejects a check deposit and returns a substitute check to the customer makes the warranties under 229.52(a)(1), regardless of whether the depository bank receives consideration in connection with the item. This revision would provide an important clarification of Check 21 and related indemnity for substitute checks.</td>
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Other Issues for Comment

**Presumption of Altered or Forged (Counterfeit)**

Fed RFC: Currently the provisions of the UCC reflect precedence established in *Price v. Neal* (1700s English case law) that the paying bank, rather than the depositary bank, is in the best position to judge whether the drawer’s signature on a check is the authorized signature of its customer. By contrast, in today’s environment of image processing, the depositary bank is arguably in a better position than the paying bank to inspect the check at the time of deposit and detect an alteration to the face of the check, or determine that the amount of the check is unusual for the depositary bank’s customer.

The Fed requested comment on whether, in cases of doubt, a check should be presumed to be altered or forged. The Board also requested information on whether forged (counterfeit) or altered checks were more common.

Working Group: The Working Group supported adding to Reg CC a presumption of alteration in the event there is insufficient evidence to determine whether or not a particular check image was altered or is a counterfeit item. The Working Group believed there would be value to having a predictable and uniform national rule for this type of dispute. The ECCHO Rules currently have a presumption of alteration. This rule was adopted after careful consideration of the options. It is the view of ECCHO members that, in the absence of evidence, it is more likely that the item has been altered than forged.

**Limiting Use Of “Refer to Maker”**

Fed RFC: Returned checks must state a reason for return. According to the Federal Reserve, “Refer to Maker” is an instruction—not a return reason. Recently, “Refer to Maker” has been overused and misused. The proposal would clarify use of “Refer to Maker” as: 1) permissible when drawer with positive pay arrangement instructs bank to return check; 2) not permissible when check is being returned due to paying bank having already paid the item.

Working Group: The Working Group supported the decision not to ban the use of “Refer to Maker” as a return reason. The Working Group stated that “Refer to Maker” serves well when there is not an available return code to describe the situation. Examples include: 1) when the paying bank suspects fraud but does not have sufficient information; (in this case, “Refer to Maker” is more appropriate than a return code reason that references fraud) and 2) when, due to the midnight deadline, the paying bank does not have time to resolve conflicting return reasons.

The Working Group agreed that “Refer to Maker” should not be used in cases of duplicate presentment. They also supported the practice of referring to return reasons within operating standards rather than in Reg CC. Therefore the Working Group also recommended eliminating the reference to “Refer to Maker” in the commentary of Reg CC.

**Using X9 Standards For Indorsements**


Working Group: The Working Group recommended maintaining a version of Appendix D in Reg CC in order to clearly establish, as a matter of regulation, the responsibilities of banks with regards to indorsements. There has been a growing problem with BOFDs not complying with the requirements in Appendix D for the BOFD indorsement and cluttering the back of the check image. This non-compliance complicates and delays the return of items. There is concern that if Reg CC defaults to industry standard, there will be more non-compliance issues.

**ECCHO: Your Source for Check Industry Information**

ECCHO, the Electronic Check Clearing House Organization, is the source for everything check. ECCHO is a not-for-profit, mutual benefit, national clearinghouse, that is 100% owned by 3,000+ financial institutions in order to provide: Industry Advocacy, ECCHO Rules, Check Education, and NCP Certification

For more info on ECCHO:  www.eccho.org or Scott Miller at smiller@eccho.org or 406.442.4994

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