



June 19, 2017

Overview of Regulation CC Final Rule

This session is eligible for 1.8 NCP CE credits

Disclaimer

This session provides an overview of various aspects of the check payments systems including legal and rules framework for check image exchange. Responsibility for compliance with image exchange rules and/or legal, operational and regulatory requirements applicable to check image exchange remains at all times with the financial institution participating in check image exchange and/or the individual or company using a check image exchange service.

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Financial institutions should consult with their legal counsel regarding legal and operational requirements applicable to any check image exchange program they may offer or in which they participate.

- Background On Regulation CC and Proposals
- Updated Definitions
- Electronic Check and Electronic Returned Check
 - Definition
 - Warranties
- Expeditious Return
 - Notice of non-payment
- New Indemnifications
 - Electronically Created Item
 - Remote Deposit Capture
- Variation by Agreement
- Other Issues
- RFC on Presumption of Alteration

- Fed amending Subparts C and D of Regulation CC to facilitate banking industry's ongoing transition to fully-electronic check collection and return process
 - Issued May 31, 2017
 - Takes effect on July 1, 2018
 - Final Rule and overview can be found at
 - <https://www.eccho.org/eccho-sb-memo>
- Also requesting comment on presumption of alteration for certain disputes
- Proposed revisions to Subpart B remain outstanding; joint authority with Fed and CFPB over Subpart B

- Federal Reserve has one check processing site
 - All checks “local” for expeditious return timeframe under Regulation CC
 - Electronic return almost always meets this return timeframe
 - Federal Reserve was seeking in proposal to address how to encourage electronic returns
- Requests for Comment on changes to Regulation CC issued in 2011 and 2014
 - Group response by ECCHO, ABA, The Clearing House, Financial Services Roundtable and ICBA

- Subpart A – definitions
- Subpart B – funds-availability provisions
 - Implements the Expedited Funds Availability Act of 1987
 - Due to Dodd-Frank now joint jurisdiction with CFPB
- Subpart C – collection and return of checks
 - Adopted by Fed pursuant to regulatory authority granted to it under EFAA
 - Establishes expeditious return requirement for checks on paying banks and returning banks
- Subpart D – substitute checks
 - Implements Check 21 Act of 2003
- Until the Final Rule, Reg CC did not address:
 - Exchange or return of electronic images of paper checks
 - Electronic items not derived from paper checks (ECIs)
 - Responsibility between two BOFDs for duplication in Remote Deposit Capture

- Routing Number – Section 229.2(dd)
 - 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 an electronically-created item
- MICR Line – Section 229.2(vv)
 - Includes the number contained in the MICR line data in accordance with X9.100-187
- Copy and Sufficient Copy – Section 229.2(bb)
 - Copy to include electronic reproduction of check that recipient has agreed to receive instead of paper

- 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 that
 - Is sent to receiving bank pursuant to an agreement between sender and receiving bank; and
 - Conforms with ANS X9.100-187
- Check image and information must be “derived” from paper check
 - Use of “derived” meant to clarify that image must be created from paper item
 - ECIs (defined below) are not electronic checks

- Commentary: Electronic check/returned check
 - Both electronic image and electronic information must be sent
 - Can be sent separately or together
 - Banks may agree to send to intermediary who stores on behalf of receiving bank and makes available
 - Establishes X9.100-187 as applicable standard or banks can agree to other standard

- Electronic check/returned check 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 Rule does not give bank right to send electronic check or electronic returned check absent agreement
 - Agreement can be bilateral/clearinghouse/operating circular/other form of interbank agreement
- Application of Reg CC provisions to electronic checks includes:
 - Notice of nonpayment
 - Expeditious return
 - Standard Reg CC Warranties

- Final Rule adopts new warranties that apply only to electronic check/returned check – Section 229.34(a)
- Each bank that transfers or presents electronic check/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 accurate record of all MICR line information required for substitute check and amount of check, and
 - No double debit warranty
 - Warranties worded similar to Check 21 warranties

- Warranties made by sending bank
 - For collection or presentment, to transferee bank, any subsequent collecting bank, paying bank and drawer
 - For return, to transferee returning bank, any subsequent returning bank, depository 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 Reg CC warranties applicable to paper/returned check also apply to electronic checks/returns
 - 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
 - Note: ECCHO Rules/Reg. J provide for certain indemnifications to support Check 21 liability pass-back
- No warranty application to ECIs - not “electronic check”
- Check image warranties may be varied by agreement, but variation limited to persons bound by agreement
 - Section 229.37

ECCHO *New 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 depository bank (i.e., BOFD) such that check would normally be received by depository bank no later than 2:00 p.m. (depository bank local time) on second business day following banking day on which check was presented to paying bank
 - Previously was 4:00 p.m.
 - New Commentary: To determine “normally” paying bank may rely on returning bank’s return deadlines and availability schedules for electronic return

ECCHO *New Expeditious Return Rule*

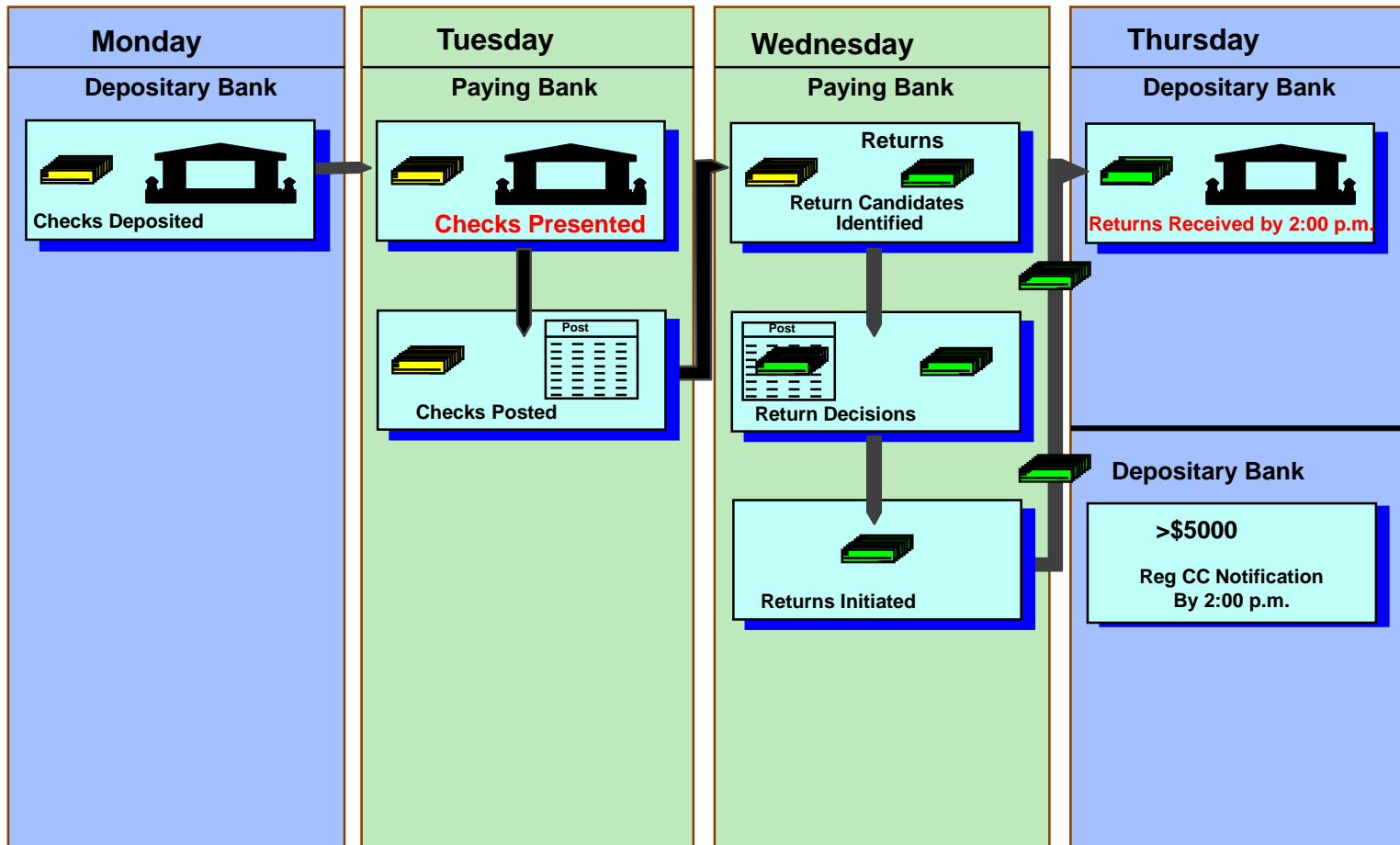
- Eliminates current four (4) day and forward collection return tests
- Return may be sent to depositary bank or returning bank agreeing to handle return
- Return reason must be maintained on any subsequent substitute check
- Paying bank not responsible for unforeseeable delays of return such as communication failures
- Final Rule adopts similar expeditious return requirement for returning banks

ECCHO *New Expeditious Return Rule*

- 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
 - Fact specific determination
 - Liability approach encourages depositary bank to accept electronic return checks

- Exceptions to expeditious return obligation
 - Sections 229.31(d) and 229.32(c)
 - Check deposited in depository bank not subject to Subpart B
 - Depository bank with only time or savings accounts or credit card accounts
 - Paying/returning bank unable to identify depository bank of check
 - New Commentary: If no electronic addenda record, paying bank must examine image to determine depository bank
 - For returning bank when it handles a misrouted returned check

Expeditious Return



Notice of Non-Payment

- Notice requirement applies to electronic checks as well as paper checks – Section 229.31(c)
 - Changes
 - Increases dollar threshold to \$5,000 (previously \$2,500)
 - Time for receipt by depository bank 2:00 p.m. (previously 4:00 p.m.) depository bank local time
 - Delivery standard to parallel new expeditious return standard
 - New exception for paying bank from notice requirement if depository bank is unidentifiable
 - Change in content requirements for notice – see below
 - Final Rule maintains current obligation on paying bank to use indicator to note information of “uncertain” accuracy

Content of Notice

- To the extent available to paying bank
 - Information contained in MICR line as received by paying bank and following information

Current Requirement	Final Rule Requirement
Changed Content	
Trace number associated with indorsement of depositary bank	Bank name, routing number and trace or sequence number associated with indorsement of depositary bank
No Change	
Name of the Payee(s)	Name of Payee(s)
Amount	Amount
Date of indorsement of depositary bank	Date of indorsement of depositary bank
Reason for nonpayment	Reason for nonpayment
No Longer Required	
Name and routing number of paying bank	
Account number of customer of depositary bank	
Branch name or number of depositary bank from indorsement	

- Final Rule retains 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

- Under current Reg CC, extension of UCC midnight deadline is available if paying bank relies on courier's delivery schedule and uses return method that "ordinarily" would result in receipt by depositary bank by 2:00 p.m. deadline
- Final Rule establishes new requirement of "actual" receipt – Section 229.31(g)
 - This is a more limited exception
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- Paying bank may extend UCC midnight deadline to time of dispatch of returned check:
 - Provided that depository bank actually receives returned check on next banking day (after otherwise applicable midnight deadline) by earlier of 2:00 p.m. (depository bank local time) or close of its banking day, or
 - If UCC midnight deadline falls on Saturday which is banking day for paying bank, depository bank or returning bank actually receives returned check on next banking day (after otherwise applicable midnight deadline) by its cut-off hour for next processing cycle
 - Commentary: Time of receipt can be set by agreement of banks for electronic return

- Electronic Image that has all attributes of electronic check/returned check but was created electronically and not derived from paper check
 - Section 229.2(hhh)
 - Also know as: Electronic Payment Order (EPO)
- Never existed in paper form and does not meet definition of electronic check
 - ECI cannot be used to create substitute check that is legal equivalent

- Commentary provides 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

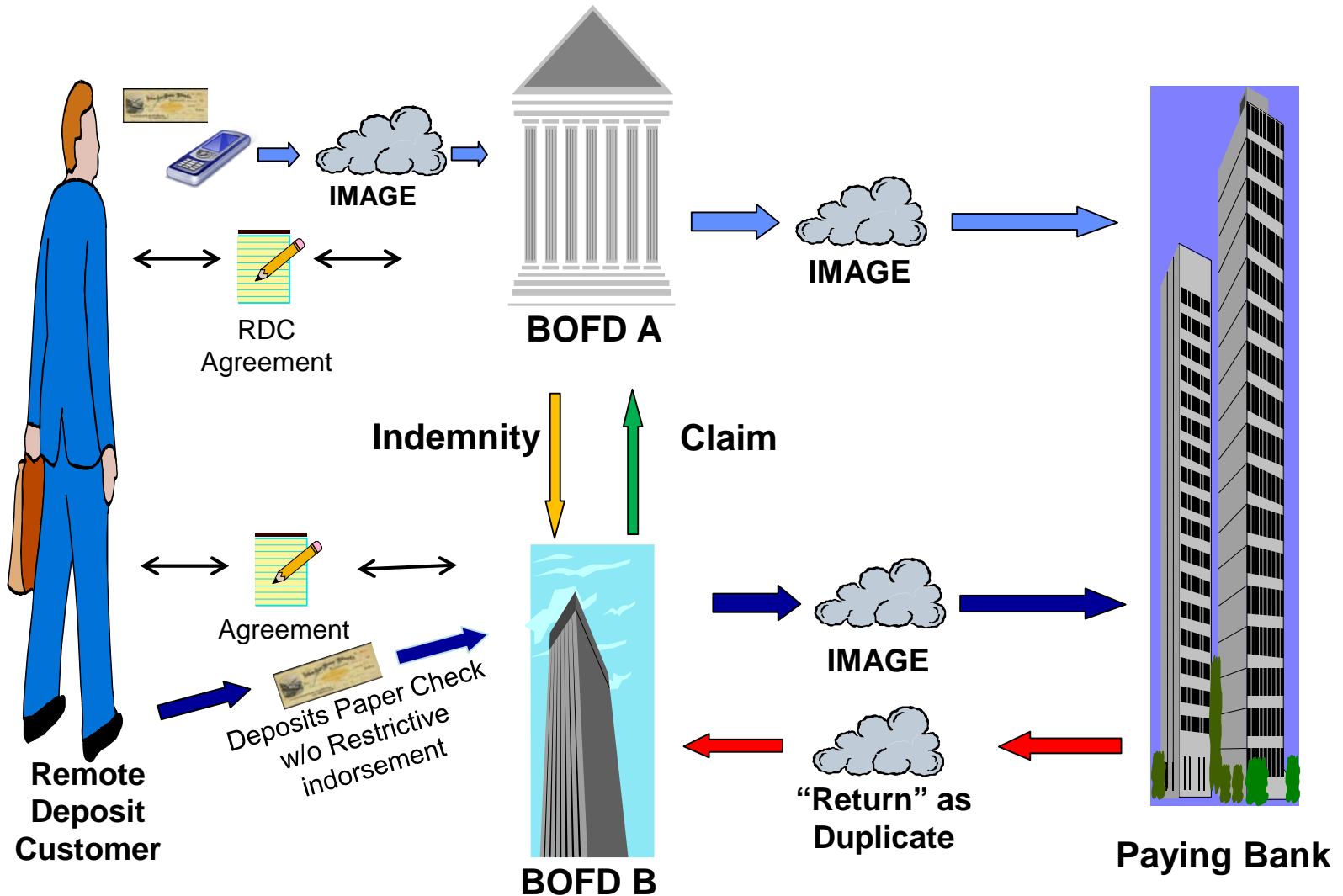
- Section 229.34(g)
- New indemnities cover losses caused by
 - ECI not derived from paper check
 - Could include Reg E losses incurred by paying bank
 - ECI not authorized by account holder or
 - Subsequent bank pays an item that has already been paid
- Indemnity shifts losses to depository bank
- Depository bank may allocate liability to depositor in its customer agreement
- Indemnity does not extend to owner or drawer
- ECIs not “electronic checks” under rule
 - Not subject to other provisions of Reg CC
 - Such as expeditious return or warranty provisions

- Section 229.34(f)
- New indemnity to protect second depository bank that received deposit of paper check that was returned unpaid because check previously deposited at another depository bank using RDC service
- Indemnity provided by first depository bank that
 - Is 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

- Depository bank indemnifies second depository bank that accepts original check for deposit, for losses incurred by second depository bank if loss is due to check having already been paid
 - Scope of damages limited to consideration received plus expenses/attorneys fees
 - Comparative negligence defense available
- Depository bank does not make indemnity if original check bore restrictive indorsement inconsistent with means of deposit
 - Example: “for mobile deposit at [name of first depository bank] only”

- First depository 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
- This indemnity permits depository bank that accepts original paper check to make claim against depository 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

Remote Deposit Capture



- 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 rules

- Presentment/Return of Electronic Checks – Section 229.36(a)
 - Terms for presentment and return of electronic checks determined by agreement of exchanging banks
 - Terms for agreement may include:
 - Electronic address for sending electronic checks
 - When presentment occurs
 - Receiving bank may require separation of return and forward items
- Writings – Section 229.30(b)
 - Bank may send in electronic form information and notices otherwise required under Reg CC to be in “writing,” if agreement to do so
 - 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 Rule
- 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 Rule recognizes this return reason can be appropriate in some cases
 - May be appropriate when drawer with positive pay arrangement instructs bank to return check
 - Not appropriate when check is being returned due to paying bank having already paid item, where check has been altered or is unauthorized

- Same Day Settlement – Section 229.36(d)
 - Retains current SDS rule and only applies to paper presentment
 - Settlement of presentment of electronic checks governed by agreement of parties
- Indorsements – Section 229.35
 - Eliminates Appendix D – Indorsement, Reconverting-Bank Identification and Truncation Bank Identification Standards
 - Refer to X9 industry standards for indorsement for paper check (X9.100-111), substitute check (X9.100-140) and electronic check (X9.100-187)

- 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
 - Felt not needed with single check processing region

- Presumption of Alteration

- Requests comment whether Regulation CC should adopt evidentiary presumption as to whether, in cases of doubt, check should be presumed to be altered rather than a forgery
 - Dollar amount or payee on substitute or an electronic check or
 - 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
- Also considering
 - Whether alteration presumption should apply to claim that date of check was altered
 - Whether presumption should apply if bank claiming presumption destroyed original check

- Comments due within 60 days of publication in Federal Register

Wrap-Up and Questions



- This webinar was provided for financial services industry
 - Participation in future Reg CC calls is limited to ECCHO Ops Committee, ECCHO Subcommittees and certain industry trade associations
 - Invitations have been sent out
 - Materials will be sent out prior to calls to invitees
- Meetings to develop response to RFC
 - Wednesday, June 14 at 2:00 pm ET
 - Friday, June 23 at 11:00 am ET
 - Monday, July 10 at 11:00 am ET
- ECCHO drill down on Final Rule with ultimate goal to update ECCHO Rules in light of amended Regulation
 - Thursday, July 6th at 11am ET
 - Tuesday, July 18th at 3pm ET
 - Friday, August 4th at 11am ET
 - Monday, August 14th at 2pm ET
 - Thursday, August 31st at 2pm ET



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Thank You

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