ECCHO Rules 9 At A Glance

Forged & Counterfeit Check Warranties

What is Rule 9?

Rule 9 is an ECCHO Rules' warranty in which a Depositary bank warrants to the Paying bank that (i) the signature of the purported drawer is not forged or otherwise unauthorized, and/or (ii) the related physical check is not counterfeit. The official name and location of Rule 9 is ECCHO Rules Section XIX(O)).

Who can Use Rule 9?

Rule 9 is only available for check images exchanged among ECCHO members who have agreed to use the Rules and have not opted out of Rule 9.

What is the Purpose of Rule 9?

Forged and counterfeit items are sometimes recognized by bank customers after the midnight return deadline. Rule 9 allows the Paying bank to file a claim to recover from a fraudulent item after the UCC midnight return deadline. Rule 9 shifts responsibility, in some cases, from the Paying bank (as assigned in UCC Article 4 (4-407 & 4-408) to the depositor when there are sufficient funds in the depositor's account.

Why Shift Responsibility?

Checks are no longer processed as in the past:

- Financial institutions (FIs) no longer verify signatures on all checks.
- Checks are collected using digital images so the Paying bank never sees the paper check.
- Items can be remotely deposited so even the Depositary bank does not see the physical item.

Rule 9 shifts the responsibility for counterfeit/forged items from the Paying bank to the depositor, who is in the best position to have prevented the loss. The loss remains with the Paying bank if there are insufficient funds in the depositor's account.

Evolution of Check Fraud Detection

In the 20th century, Paying banks compared signatures they held on file to the signature on each check. As volumes increased, they moved to comparing signatures above a certain amount. In the latest version of UCC, the definition of ordinary care "does not require a bank to examine an instrument" however, the Paying bank remains liable. With the advent of image exchange and remote deposit capture, physical checks are now electronified as soon as possible and manual examination is a thing of the past.

Fraud Detection Today

Today's fraud detection systems are utilized to catch more fraud than humans did--by employing behavioral rules-based systems, sophisticated signature algorithms and other advanced technologies.

Check Fraud Declining

According to the most recent Fed Payments Study check fraud has declined in both value and volume of transactions. In the ABA Fraud Study, check fraud losses reported by FIs are trending down. Successful anti-fraud strategies include advanced layered technology, risk controls, education/training and partnerships with law enforcement. Rule 9 is another useful tool in the toolkit.

How Long has Rule 9 Been Around?

In the mid 1990s Rule 9 was developed for paper exchanges in a Texas clearinghouse, where it first received its name. Financial institutions have been receiving value from Rule 9 since its inception.

How Old is US Check Law?

Where did responsibility to the Paying bank originate?
This legal tenet of US check law is based on check case law from England. The assignment of responsibility for fraud to the Paying bank dates back to a legal case from 1762--Price vs. Neal. The judge in that case, Lord Mansfield, could never have imagined how far-reaching his decision would be when he ruled to assign responsibility to the entity that verifies signatures (the Paying bank).

Clearly they did not anticipate digital images of checks in old England. Rule 9 modifies responsibility for fraud to better reflect the 21st century image environment.

The Clearing House

ECCHO

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How Does Rule 9 Work?

1) The drawer customer informs the Paying bank that an item charged to them is counterfeit or forged.

2) The drawer customer completes a written statement (WSUPP) attesting that the item is unauthorized.

3) Paying bank makes a Rule 9 "Breach of Warranty" claim under ECCHO Rules. The claim is typically made through the return mechanism--even though it is not a return.

4) Claims must be made directly to the Depositary bank at a location where returns are accepted, or to an agreed location.

5) Items must be marked "Breach of Warranty" and/or "Do Not Redeposit or Re-Present." Return codes "5" or "3" may be used to indicate warranty breach when using the image returns system.

Note:

- The customer claim to the Paying bank must be filed within 60 days of statement date. Paying bank has 15 business days to claim breach of warranty. The claim cannot go through the Federal Reserve.
- This is a claim and not an actual return so not subject to the midnight returns deadline.
- This warranty does not apply if the item was received in a non-ECCHO exchange or any paper exchange to the Paying bank.
- ECCHO Rules deadlines and processing requirements apply - see Rules for more details.

Can Rule 9 Claims be Disclaimed?

There are three primary reasons for the Depositary bank to disclaim a Rule 9 claim:

1) Sufficiency of funds test - if the claim amount exceeds the available funds in the customer's account, or if the customer has closed its account

2) Opt-out - if the BOFD has opted out of Rule 9, it is no longer a part of the process--neither accepting or sending claims. The opt-out decision is an individual FI decision that should be made by carefully weighing the risks against the benefits and under the guidance of your legal team.

3) Failure to meet deadlines for making a claim or responding to request for additional information about the claim. Please consult ECCHO Rules for specific requirements.

Analyzing the Pros and Cons of Rule 9

Some financial institutions believe that the risk for counterfeit/forgery is properly placed on the Paying bank under UCC. That was certainly true prior to the advent of image processing but the massive change in processing compels the industry to examine new practices. Moving risk to the point of entry into the check system seems reasonable. In old England, banks were expected to "know the hand of their customers." Today, it is best for banks to employ KYC policies and to introduce KYCC (know your customer's customer) policies as well.

While there has been some concern that Rule 9 results in poor customer service, in fact, Rule 9 does not govern how the customer is treated. Rule 9 is an interbank warranty. Each FI is in control of how they interact with their customers through their customer agreements. The sufficiency of funds test allows banks to disclaim Rule 9 claims when there are insufficient funds in the depositing customer's account, however the FI can choose whether to absorb the loss or charge their customer's account for the fraudulent item.

FIs should analyze their forged/counterfeit write-offs to understand which customers are experiencing losses and how often they occur. They can use this information as an opportunity to educate customers on fraud avoidance techniques, systems and policies.

FIs should form relationships with the exceptions departments of their exchange partners. It is easier to treat each other equitably when you have established working relationships. There can be a learning curve with regards to Rule 9 claims. ECCHO can assist its members with the contact information necessary to form those relationships.

Final Comments

Many banks have found Rule 9 beneficial. While Rule 9 allows the Paying bank to present a breach of warranty claim for a forged/counterfeit item to the Depositary bank, in fact the rule was designed to protect Depositary banks by allowing disclaim under certain conditions. It is also assumed that FIs act alternately as Depositary bank and Paying bank, therefore making Rule 9 fair to all.

See Rule 9 FAQs: www.eccho.org/faq
See Rule 9 Whitepaper: www.eccho.org/view-rule-9-whitepaper

For more info on Rule 9 and ECCHO membership: Scott Miller 406.442.4994 | or Jenny Johnson 770.452.0961