

Understanding “Rule 8” and “Rule 9” Warranty and Claims Processes

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This document is intended as an overview of two check warranties, one that is codified in Regulation CC and one that is defined in private sector clearinghouse rules. The related breach of warranty claim processes and deadlines for each, as defined under the ECCHO Operating Rules and Commentary (the “Rules”), will also be discussed.

Throughout this document the Remotely Created Check (RCC) definition and warranty found in Regulation CC (Section 229.2(ff) and 229.34(d) respectively), and the claims process found in the ECCHO Rules (Section XIX(N)) will generally be referred to as “Rule 8” for ease of discussion. Similarly, the Forged and Counterfeit Check Warranties and related claim process found in the ECCHO Rules (Section XIX(O)) will generally be referred to as “Rule 9” throughout this document. For information on the general purpose of the rules and the background on how they evolved, please see **Attachment I** of this document.

Rule 8 and Rule 9 are frequently discussed together since the warranty claims process in the Rules is similar for both rules. For example, when an unauthorized RCC or forged/counterfeit item is identified, the customer of the Paying Bank has to initiate a warranty claim for either Rule 8 or Rule 9. Also, each rule has a similar requirement for obtaining a written statement from the Paying Bank’s customer to initiate a breach of warranty claim which will state the specific reason the item is being disputed. The various deadline considerations, within which both the Paying Bank and Depository Bank (BOFD) must respond to either type of claim to resolve or ultimately disclaim, is also similar. Additionally, both Rule 8 and Rule 9 warranty claims may utilize the return system for processing although they are not actually returns.

Neither Rule 8 nor Rule 9 claims can be made through the Federal Reserve. While the Federal Reserve’s claim process for RCCs is briefly mentioned, the focus and descriptions in this document are based on the ECCHO rules. The Federal Reserve does not have a warranty or claim process analogous to Rule 9 under its rules and regulations for check collection.

Different Rules – Different Warranties

Rule 8 and Rule 9 are frequently discussed together though they describe two very different types of payments with different rules and warranties.

- Rule 8 claim applies to an unauthorized remotely created check (RCC) otherwise referred to as an “unsigned draft”.
- Rule 9 claims are for signature items and refer to a forged or counterfeit check, where the signature of the drawer is not that of the customer and/or the check is forged or otherwise unauthorized.

This document will discuss each of these rules separately and will discuss how each warranty applies and how a breach of warranty claim is made. It will discuss the potential risks to the BOFD and the Paying Bank as well as the default participation in Rule 9 and the ECCHO member’s option to elect to “opt-out”.

The comparisons shown in the following table are provided for ease of reference and to highlight similarities and key differences between Rule 8 and Rule 9 described in this document.

Disclaimer: This document is not intended as legal or compliance advice to any person or company. Financial Institutions should consult with their legal counsel regarding the legal and operational requirements applicable to any check image program they may offer or in which they participate. This document is for guidance purposes only, and the application of a check statute, regulation or ECCHO Rule in particular facts and circumstances may vary. In the event of any conflict between this document and ECCHO Rules themselves, the ECCHO Rules will govern.

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	Rule 8	Rule 9
Type of Payments	Remotely created check – an unsigned draft	Forged or Counterfeit check – a fraudulent signature item
Definition	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 (Regulation CC Section 229.2(ff))	Forged check – Signing of another’s signature to a document with the intent to defraud Counterfeit check – an item that is made to appear genuine with the intention of defrauding an unsuspecting person
Source of Warranty	Regulation CC (Section 229.34(d))	ECCHO Rules (Section XIX(O)) (private sector clearinghouse rules)
Warranty	A bank that transfers or presents a remotely created check and receives settlement for that item warrants that the person on whose account the check is drawn authorized the issuance of the check in the amount stated and to the payee stated on the check.	A Depository Bank warrants to the Paying Bank that (i) the signature of the drawer customer is not forged or unauthorized, and/or (ii) the check is not counterfeit.
Exchanges in Which the Warranty Arises	Federal Reserve Bank exchange , or Private sector exchange (ECCHO Rules), or Correspondent exchanges (by agreement)	Private sector exchange (ECCHO Rules)
Opt-Out Option	No - Federal law/codified in Regulation CC as amended July 2006	Yes – May elect to opt-out as defined in the ECCHO Rules
Timing	Paying bank has 90 calendar days to file breach of warranty claim.	Customer has 60 calendar days from statement date to file WSUPP with Paying Bank, the Paying bank has 15 business days to file breach of warranty claim
Claims Process	For items presented through Federal Reserve Bank process as an adjustment (WIC URCC), or Private sector exchange under the ECCHO Rules present as a warranty claim (Rule 8 - Section XIX(N)) through Return process or As an adjustment (Unauthorized RCC Warranty Claim – Section XII and Exhibit II)	For items presented under ECCHO Rules - through the return process (actually is a claim) (Section XIX(O)) or May make the claim through letter sent to return location of the BOFD.
Customer Written Statement (WSUPP) Required	Yes	Yes
Notarized	Not required to be notarized Banks at their discretion may require the customer statement to be notarized	Not required to be notarized Banks at their discretion may require the customer statement to be notarized
Reasons to Disclaim	<ol style="list-style-type: none"> 1. Claim was not made timely (See Attachment II for deadlines) 2. Other defenses as provided by Regulation CC or other applicable law 	<ol style="list-style-type: none"> 1. Claim was not made timely (See Attachment II for deadlines) 2. Depository Bank is not the first bank to which the check was transferred 3. Other defenses as provided by other applicable law 4. Depositing customer account closed 5. Claim amount exceeds funds in depositing customer account 6. Depository Bank had effective “opt-out” in place at the time of the Electronic Image exchange. Elected to have its Electronic Image exchanges not subject to this Section XIX(O) of the ECCHO rules

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Rule 8 – Remotely Created Check Warranty and Claims

What is a remotely created check? The Regulation CC (Section 229.2(ff)) definition states: *Remotely created check means 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.* Prior to Regulation CC inclusion, both the Rule 8 warranty and the Rule 8 claim process were included in the ECCHO Rules. When Regulation CC was updated in July 2006 to include the definition and warranty for a remotely created check, ECCHO removed the warranty language from the Rules and referenced Regulation CC as appropriate. The Rules now include only the warranty claim process for an unauthorized remotely created check.

Rule 8 Claim Process – ECCHO Rules

If the drawer customer provides a written claim to the Paying Bank that the check is unauthorized, and therefore that the warranty is breached, the Paying Bank can make a warranty claim back to the BOFD under the process established in Section XIX(N) of the ECCHO Rules. The Paying Bank can make this warranty claim by delivering the item to the BOFD as a check image, a substitute check or other item. The claim must be delivered to a location where the BOFD receives returns of checks or images in the normal course of check collection unless another specific delivery location is agreed upon. There is a requirement for a notation saying “Breach of Warranty” when the warranty claim is made which can be accomplished with a return reason code. The codes used in image exchange may be

- “3” (Warranty Breach) and can be used for both Rules 8 & 9 claims or
- “4” (RCC Warranty Breach (Rule 8)) that can only be used for Rule 8 claims.

When these claims are processed through the return process, it is a breach of warranty claim and not a “return” of the check. Under the Rule 8 process as described in Section XIX(N) of the Rules, there are a number of deadlines and other processing requirements that must be satisfied in order for the BOFD to be obligated to pay on the warranty claim. For a complete description of the process and all related deadlines, please see **Attachment II** of this document.

Initially, the delivery of the warranty claim had to be through the return process as described in Section XIX(N) of the Rules. The Rules now give the Paying Bank the option to make the RCC warranty claim by using the adjustment process for an Unauthorized RCC Warranty Claim as outlined in the adjustment section of the Rules and the Adjustment Matrix (Section XII Adjustment Claims and Exhibit II respectively). Note here that if the claim is made as an adjustment under this section, the claim may follow the forward presentment chain (e.g.; back through an intermediary). Regardless of how this claim is made, the BOFD cannot disclaim on the basis that the depositing customer has evidence that the paying bank’s customer authorized the payment. For claims made using the adjustment process for an Unauthorized RCC Warranty Claim, the provisions and deadlines contained in Section XIX(N) do not apply.

If the claim is made following the provisions of Section XIX(N), the Paying Bank must send the claim to the return location of the BOFD; this return process cannot be made through the Federal Reserve. The Paying Bank also has the option to make the claim outside of the ECCHO Rules (through a Federal Reserve Bank adjustment process for unauthorized RCCs) or through other action or demand.

Reasons for Depository Bank to Disclaim (only under Section XIX(N))

In general an unauthorized remotely created check claim under the Section XIX(N) process may only be disclaimed by the BOFD for reasons related to the deadline requirements under the claims process in the Rules. For a complete description of the process and all related deadlines, please see **Attachment II** of this document.

No Opt-Out of Rule 8

The remotely created check warranty is not established by agreement nor is it established under the ECCHO Rules. This is a warranty imposed on the BOFD and other transferring banks as a matter of check law as part of Regulation CC. This warranty is given by banks to other banks in the presentment chain and, in doing so, shifts the liability for the loss created by an unauthorized remotely created check to the BOFD. While the BOFD cannot “opt-out” of the warranty under Regulation CC or the Rule 8 warranty claim process, the BOFD may choose to allocate liability for a warranty claim for an unauthorized remotely created check back to its depositing customer through a customer agreement.

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Rule 9 – Forged and Counterfeit Check Warranty and Claims

The Rules include both a Rule 9 warranty and a related warranty claim process. This warranty and related breach of warranty claim process are commonly referred to as a “Rule 9 claim”. The warranty begins with the BOFD and is made by each member institution in a forward image exchange under the Rules to the Paying Bank. This warranty does not apply if there is a non-ECCHO exchange (an exchange through a Federal Reserve Bank for example) or any paper exchange to the Paying Bank.

The Rule 9 warranty applies only between ECCHO members and does not address the relationship between a BOFD and its customer. The relationship of the BOFD and its customer is governed by applicable law and the deposit agreement or other check processing agreement that may be in place between them. For example, if a Rule 9 warranty claim were made to a BOFD for an item that the Paying Bank’s customer states is either forged or counterfeit, that BOFD would need to determine that it had appropriate authority to charge the warranty claim back to its depositing customer.

Rule 9 Claim Process

The drawer customer must provide a written claim to the Paying Bank that the check is unauthorized and therefore that the warranty is breached. This claim must be filed within 60 calendar days of the date of the customer account statement showing the unauthorized item as paid. The Paying Bank can then make a warranty claim back to the BOFD under the Rules by delivering the item to the BOFD as a check image, a substitute check or other item through the return process. This return process cannot be made through the Federal Reserve. Note: This is a warranty claim and not the “return” of the check.

The claim must be delivered to a location of the BOFD where it receives returns of checks or images in the normal course of check collection unless another specific delivery location is agreed upon. As long as the claim is made to that location, the Rules do not require the claim to be made through the return process (even though that is typically how it is handled); the Paying Bank can make the claim through a demand letter to the return location. A sample letter can be found in the ECCHO Rules, Exhibit VIII (Sample Letter for Section XIX(O)). When the warranty claim is made, there is a requirement for a notation saying “Breach of Warranty” that can be accomplished with a return reason code. The codes used in image exchange may be

- “3” (Warranty Breach) that can be used for both Rules 8 & 9 claims or
- “5” (Forged and Counterfeit Warranty Breach (Rule 9)) that can only be used for Rule 9 claims.

The Rule 9 process includes a number of deadlines and other processing requirements that must be satisfied in order for the BOFD to be obligated to pay on the warranty claim. For a complete description of the process and all related deadlines, please see **Attachment II** of this document.

Reasons for Depository Bank to Disclaim

A forged or counterfeit check that is the basis for a Rule 9 breach of warranty claim may be disclaimed by the BOFD for a number of reasons. There are two reasons for the BOFD to disclaim a Rule 9 claim that are unique.

1. “Sufficiency of funds” test - This simply means that if the claim amount exceeds the available funds in the depositing customer’s account, or if the customer has closed its account, the claim may be disclaimed by the BOFD. If there are sufficient funds in the account the BOFD is liable for the claim (regardless of whether or not the BOFD charges the customer’s account for the warranty claim).
2. Opt-out - If the BOFD had in place at the time of the Electronic Image exchange a valid opt-out election from coverage under Rule 9, the BOFD may disclaim the warranty claim.

Other reasons to disclaim are similar to the Rule 8 claim process and relate to the required deadlines for the Paying Bank to make the claim or respond to a request for additional information about the claim. For a complete description of the process and all related deadlines, please see **Attachment II** of this document.

Opt-Out Process for Rule 9

All ECCHO members are subject to the “Rule 9” warranty unless a member affirmatively opts out from coverage. The Rules permit a member to opt-out of this warranty for all electronic images that the member sends and receives under the Rules. This opt-out may be limited if the member is subject to another agreement that makes the rule mandatory (e.g. another clearinghouse rule or direct exchange agreement). A member that chooses to opt-out of Rule 9 will no longer be required under the Rules to accept a Rule 9 claim from another ECCHO member. However, while an opt-out election is in place, the member also may not make a Rule 9 claim to another member to recover a loss from a forged or counterfeit item on behalf of its customer.

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An ECCHO member (financial institution) can opt-out (or cancel an existing opt-out) by communicating that decision to ECCHO by an authorized representative that is also an officer of the financial institution. The financial institution will receive a confirmation via email or in writing of ECCHO's receipt of such decision and that communication will also outline the effective date of the opt-out (or cancellation date of the opt-out) along with any other essential information. If the member is a Sponsored Member, then the member's authorized representative must notify their Sponsoring Organization who will in turn be responsible for notifying ECCHO. Please note the opt-out in this situation is not considered effective until the Sponsoring Organization contacts ECCHO and a confirmation is issued by ECCHO.

For complete details on the opt-out process and related deadline, please see the ECCHO website at: https://www.eccho.org/memberships_rule9. The list of the ECCHO members that have opted out is also listed on the website.

Why Do Some Banks Opt-Out

Some member institutions do not support a rule that allows the Paying Bank to make a warranty claim on the basis that the drawer signature is unauthorized, viewing this signature responsibility appropriately placed on the Paying Bank under the UCC (See **Attachment I** for more information on the History of Rule 9). Some members also object as BOFD, to charging their customers' accounts (when funds are available) or to becoming liable for this type of warranty claim to the Paying Bank if they do not charge the customer account for the claim.

Risks vs. Benefits

The ECCHO Rules are voluntary until such time as two members agree to exchange under the Rules, then all those exchanges must follow the provisions of the Rules. It is generally assumed that all ECCHO members exchanging check images are acting alternately as BOFDs and as Paying Banks and therefore have the same opportunity to make a claim and to have a claim made on them.

Customers of a BOFD may be impacted when an ECCHO member chooses to participate in Rule 9 and subsequently charges back a warranty claim. Some banks may view this potential impact to their customers as an unsatisfactory customer service risk. (Note that Rule 9 does not require that the BOFD charge the warranty claim to the depositing customer's account). The countervailing risk to this BOFD is the risk of potential loss to the bank (when acting as a Paying Bank) if its drawer customer makes a claim for a counterfeit or unauthorized check. The provisions of the UCC typically place the risk of an unauthorized check with the Paying Bank if the unauthorized check is not determined and subsequently returned within the midnight return deadline. If a Rule 9 warranty claim is available to the Paying Bank, it may be able to move this risk to the BOFD (or the BOFD's customer) in most cases.

For more information on Rule 8 and Rule 9, please review the ECCHO Rules or review FAQs on the ECCHO website at <https://www.eccho.org/faq>.

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ATTACHMENT I

History and Purpose

Under the Uniform Commercial Code(UCC) as adopted by the states, the Paying Bank is accountable for a check drawn on its customer’s account. If the Paying Bank does not dishonor the check within the appropriate deadline (referred to as the “midnight deadline”), the bank becomes responsible for that item. Under its customer agreement, the Paying Bank would likely charge the item to its customer’s account. However, if the customer claimed such check to be forged or counterfeit, the Paying Bank would have the final responsibility and would reverse the charge to the customer’s account.

This responsibility to the Paying Bank is codified in UCC Article 4 (4-207; 4-208) and is based on the court case of Price v. Neal that was decided in 1762 in the English court system. The basis for the case was the commonly held idea that the Paying Bank should know the signature of its drawer customer. Modern check processing systems have eliminated this review process for the bulk of checks processed today. Today a check passes from BOFD through to the Paying Bank and to its customer with very little human intervention or review.

ECCHO members have been following the provisions of Rule 9 or similar warranty provisions under clearinghouse rules since the mid 1990s, first under the paper check exchanges and increasingly over the last few years under the image exchange rules. In the 1990’s several local paper check clearinghouses considered a rule that by agreement would allow the clearinghouse members to move the risk for a forged or counterfeit item from a Paying Bank back to a BOFD and potentially to the depositing customer under the BOFD’s customer deposit agreement. This was accomplished by clearinghouse members adopting a rule allowing the Paying Bank to make a breach of warranty claim; the initial rule was developed in Texas and then followed by other clearinghouses. The rule and related warranty were commonly referred to as “Rule 9”. The support for this rule in these clearinghouses was based on the premise that with increasingly sophisticated technology, it was becoming much easier for forged and counterfeit checks to be created, and much more difficult for the Paying Banks to detect them. It was thought that the BOFD, its customer and/or the customer’s customer would be in a better position to identify fraudulent items as they were dealing directly with the parties creating and/or depositing those items. As paper check processing evolved and became increasingly electronic from end-to-end, the rules and agreements supporting the process, including the ECCHO Rules, included a Rule 9 provision.

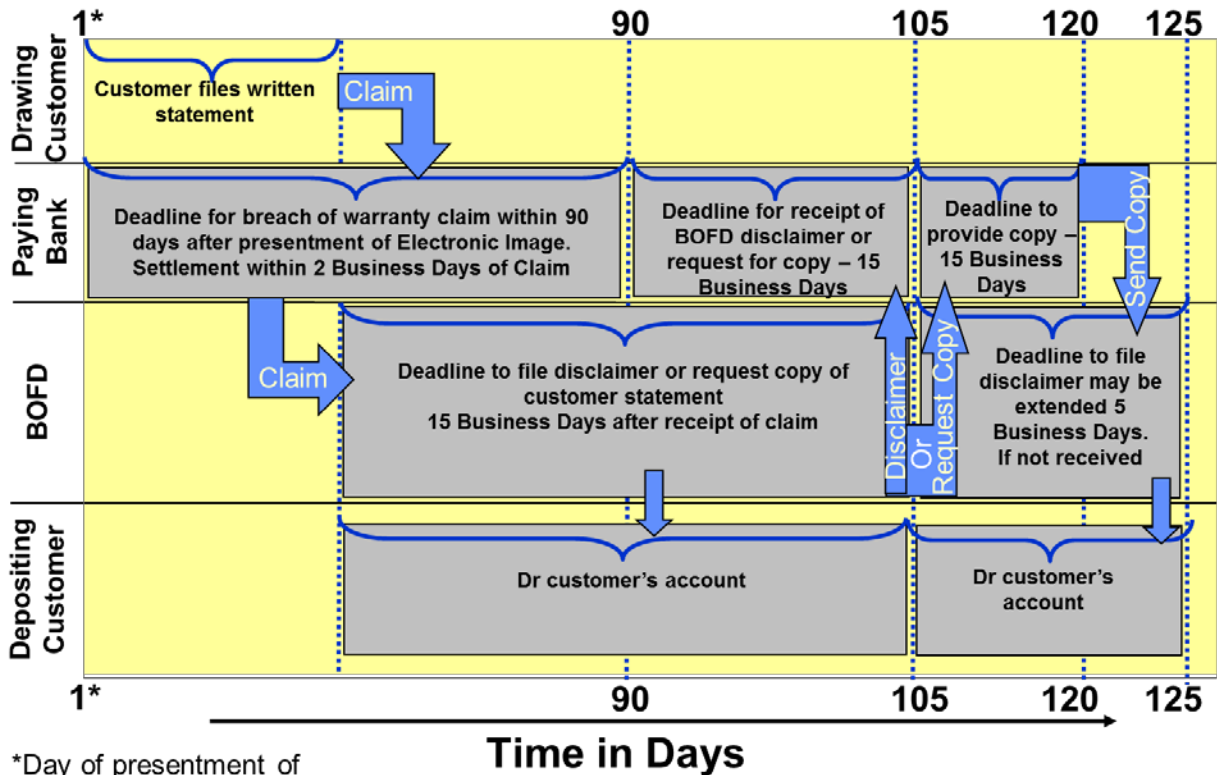
Rule 8 and Rule 9 are part of these improvements in the check payments system to improve the overall process, look for efficiencies and provide balanced protections wherever possible for the financial institutions exchanging checks and later check images. The growth in remotely created checks resulted in more focus on the Rule 8 warranty and the related breach of warranty claims process. The definition of a “remotely created check” and the related warranty were added to Regulation CC in a July 2006 amendment. A Rule 8 claim is based on a breach of the Regulation CC warranty. Only the Rule 8 claim process for an unauthorized remotely created check is included in the ECCHO Rules, and not the warranty from the BOFD.

The Rule 9 warranty and claims process evolved as a way to allow the banks involved in the paper and electronic check exchange process to share in the potential risks of a new more fully automated environment. Through a Rule 9 claim, the Paying Bank could be in a position to recover funds paid on a fraudulent item from the BOFD. It should be noted however that while Rule 9 does allow the Paying Bank to present a breach of warranty claim for a forged or counterfeit item back to the BOFD, the rule was designed to protect the BOFD. The provisions of the rule allow several reasons for the BOFD to disclaim the Rule 9 claim. A key reason to disclaim a warranty claim is if sufficient funds are not available in the account of the depositing customer. The BOFD could then disclaim the Rule 9 breach of warranty claim and the loss would remain with the Paying Bank. The BOFD may also have the authority through its customer agreement(s) and at its discretion to chargeback a paid Rule 9 warranty claim to the depositing customer.

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ATTACHMENT II Section XIX(N) Timeline and Process (Rule 8 Claims)

The following chart shows a summary of the requirements and related timeline for four parties to the warranty claim process: the Drawing Customer (Customer of the Paying Bank), the Paying Bank, the BOFD, and the Depositing Customer. The steps and timing illustrated in the graphic below are described here.



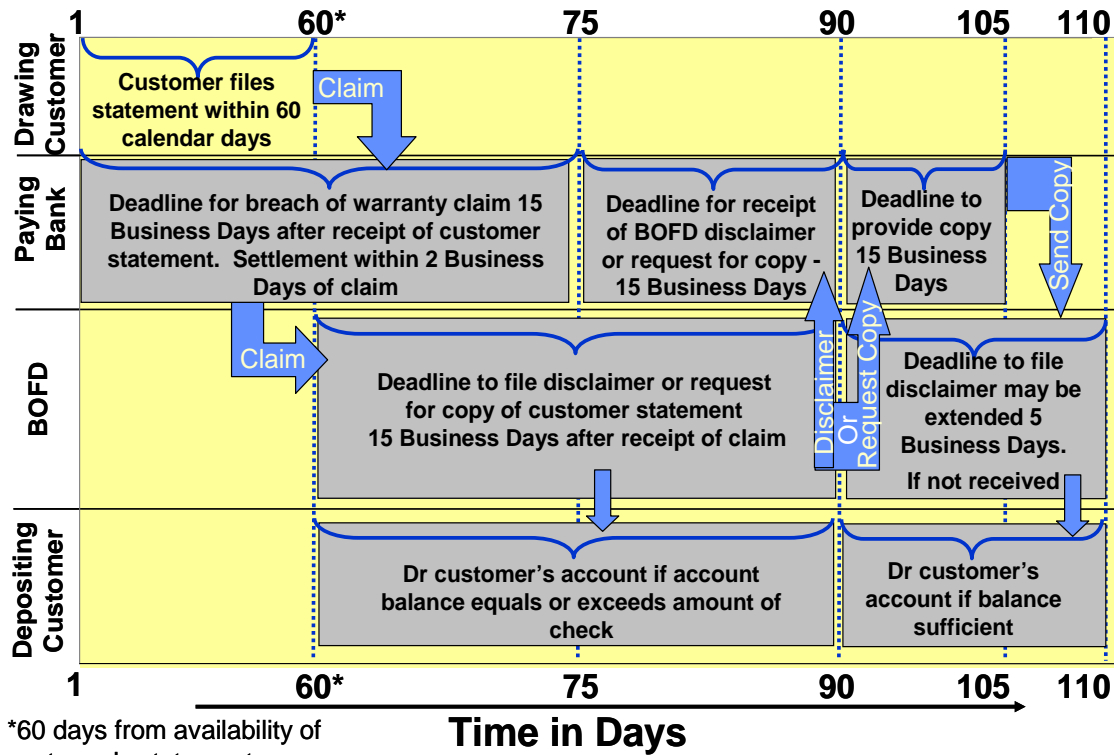
*Day of presentment of Electronic Image

- Paying Bank's customer files a customer written statement under penalty of perjury (WSUPP) with the Paying Bank
- Paying Bank has 90 Calendar Days within which to file a breach of warranty claim with the BOFD
- BOFD that receives claim within the proper timeframe then may:
 - Provide disclaimer notice back to the Paying Bank within 15 Business Days of the receipt of the breach of warranty claim if able to disclaim; or
 - Request a copy of the Paying Bank customer's written statement within 15 Business Days of the receipt of the breach of warranty claim
- Should a copy of the customer written statement be requested, Paying Bank has 15 Business Days to provide
- BOFD may extend deadline by 5 Business Days if customer written statement is not received.
- BOFD cannot disclaim on the basis that the depositing customer has evidence that the paying bank's customer authorized the payment

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Section XIX (O) Timeline and Process (Rule 9 Claims)

The following chart shows a summary of the requirements and related timeline for four parties to the warranty claim process: the Drawing Customer (Customer of the Paying Bank), the Paying Bank, the BOFD, and the Depositing Customer. The steps and timing illustrated in the graphic below are described here.



- Paying Bank's customer has 60 calendar days from the date their statement is available to file a customer written statement under penalty of perjury (WSUPP) with the Paying Bank
- Paying Bank has 15 Business Days within which to file a breach of warranty claim with the BOFD
- BOFD that receives claim within the proper timeframe then may:
 - Provide disclaimer notice back to the Paying Bank within 15 Business Days of the receipt of the breach of warranty claim if able to disclaim; or
 - Request a copy of the Paying Bank customer's written statement within 15 Business Days of the receipt of the breach of warranty claim
- Should a copy of the customer written statement be requested, Paying Bank has 15 Business Days to provide
- BOFD may extend deadline by 5 Business Days if customer written statement is not received.
- **BOFD may disclaim if customer's account is closed or if claim exceeds account balance**
 - Note: BOFD's option to charge their depositing customer with the claim is based on their customer deposit agreement(s) and not covered in the ECCHO Rules