

# Regulation CC Scenarios



Tiller Endeavors, LLC

*To Steer the Course You Need a Tiller!*

**October 25, 2018**

# NOTICE

- **Nothing in these comments should be understood as legal advice!**
- **We are not attorneys and we are not providing legal advice!**
- **Should you or your company require legal counsel, you should consult with a competent attorney!**
- **The opinions expressed here are ours unless otherwise noted!**

# Topical Agenda

- **Introduction**
- **Regulation CC**
  - Electronic Check and Electronic Returned Check Warranties
  - Remote Deposit Capture Indemnity
  - Statute of Limitations
- **Concluding Remarks**

# Introduction

## • Overview

- Fed issued Requests for Comment on changes to Regulation CC in 2011 and 2014
  - ✓ Fed amended Subparts C and D of Regulation CC to facilitate banking industry's ongoing transition to fully-electronic check collection and return process
    - Updated definitions in Subpart A, as appropriate
- Final Rule issued May 31, 2017
  - ✓ Took effect on July 1, 2018
  - ✓ Final Rule can be found at
    - <https://www.gpo.gov/fdsys/pkg/FR-2017-06-15/pdf/2017-11379.pdf>
- After July 1, 2018, issued final rule on Presumption of Alteration for certain disputes
  - ✓ Effective January 1, 2019 – No implementation requirements
- Proposed revisions to Subpart B remain outstanding
  - ✓ Joint authority with Fed and CFPB over Subpart B

# Introduction

## • Scenarios

- Since May 2017 industry working on Rules, agreements, processing and software updates
- Now time to think about scenarios
- Assumes audience is familiar with Uniform Commercial Code (UCC) and modifications to Regulation CC
  - ✓ If not, check out <https://www.eccho.org/eccho-ecchoinsights>
  - ✓ This is an advanced session
- Statutory and regulatory provisions reviewed as needed

# New Warranties



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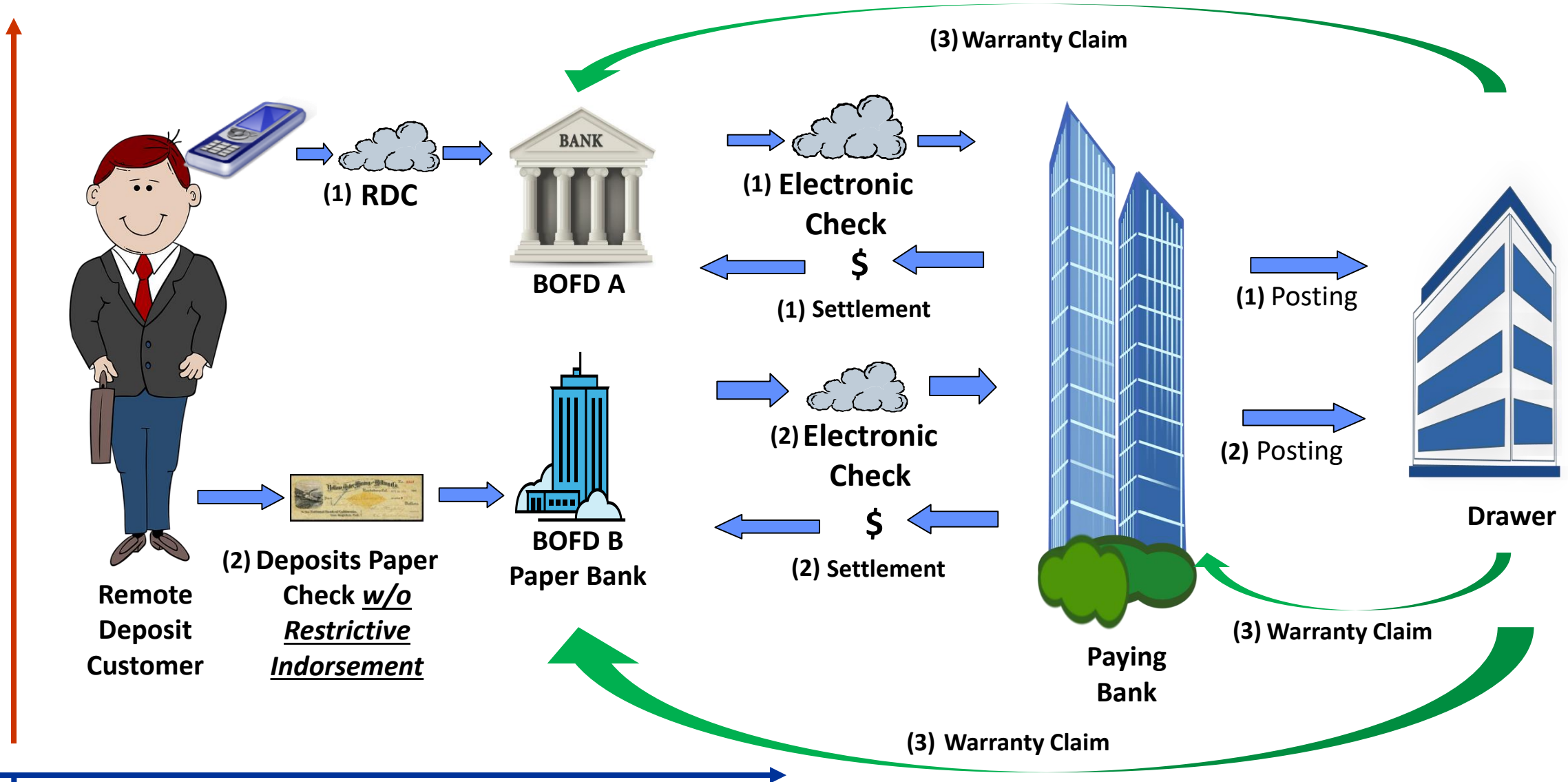
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## Electronic Check & Electronic Returned Check

# Electronic Check/Electronic Returned Check

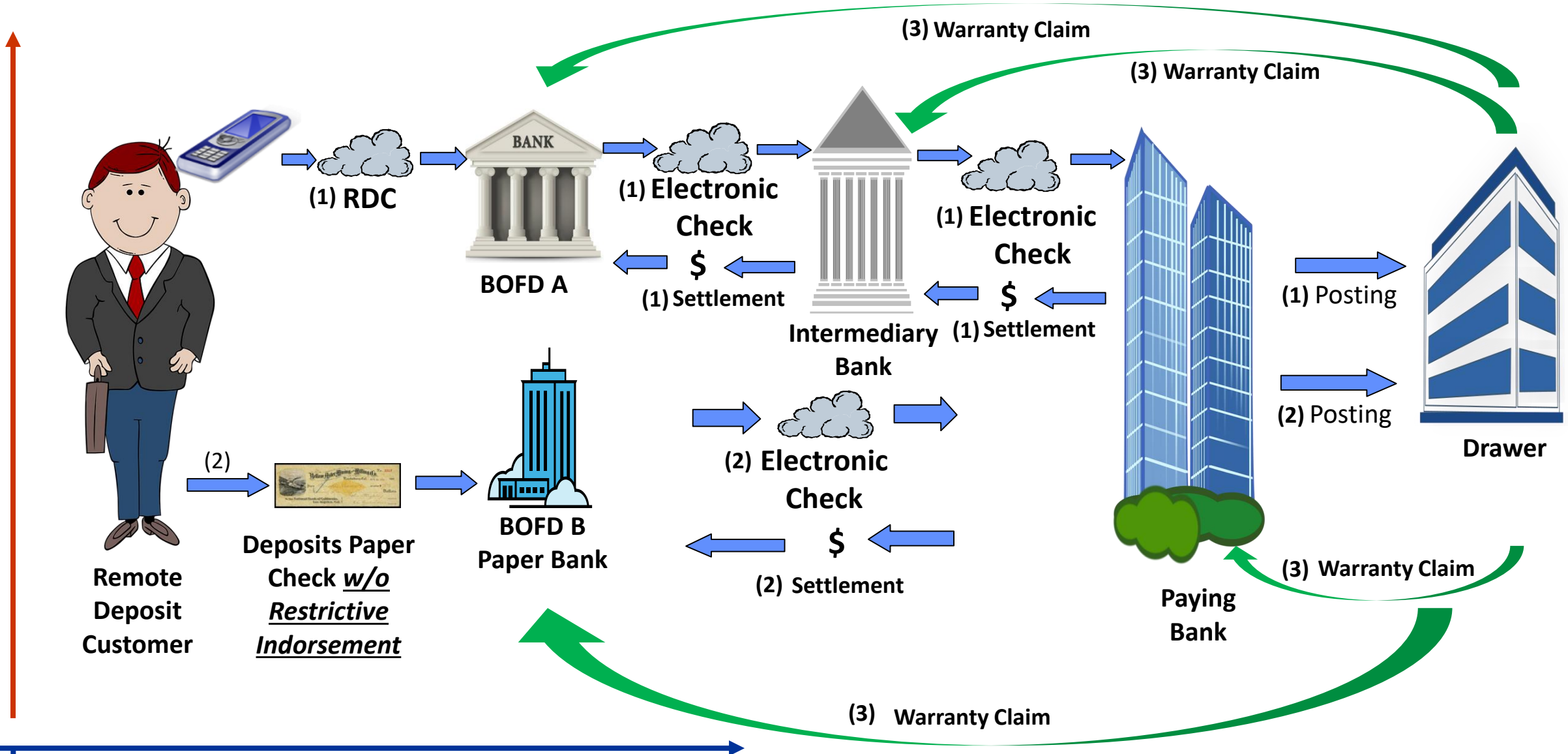
- **Added definitions and coverages for Electronic Check and Electronic Returned Check**
  - Images derived from original paper checks
  - Forward collection and unpaid returns
- **Creates new warranties under Regulation for Electronic Checks**
  - No duplicate payments
  - Information accurately represents all of the information from front and back of paper check
  - Information contains accurate record of all MICR line information
  - Warranties are made to all parties in collection/presentation/return chains including banks and persons:
    - ✓ Drawer customer on forward collection and
    - ✓ Owner of check including depositing customer/payee on return
- **Prior to updated Regulation similar warranties existed under ECCHO rules and Reg J**
  - But those warranties did not extend to non-banks

# Electronic Check Warranties





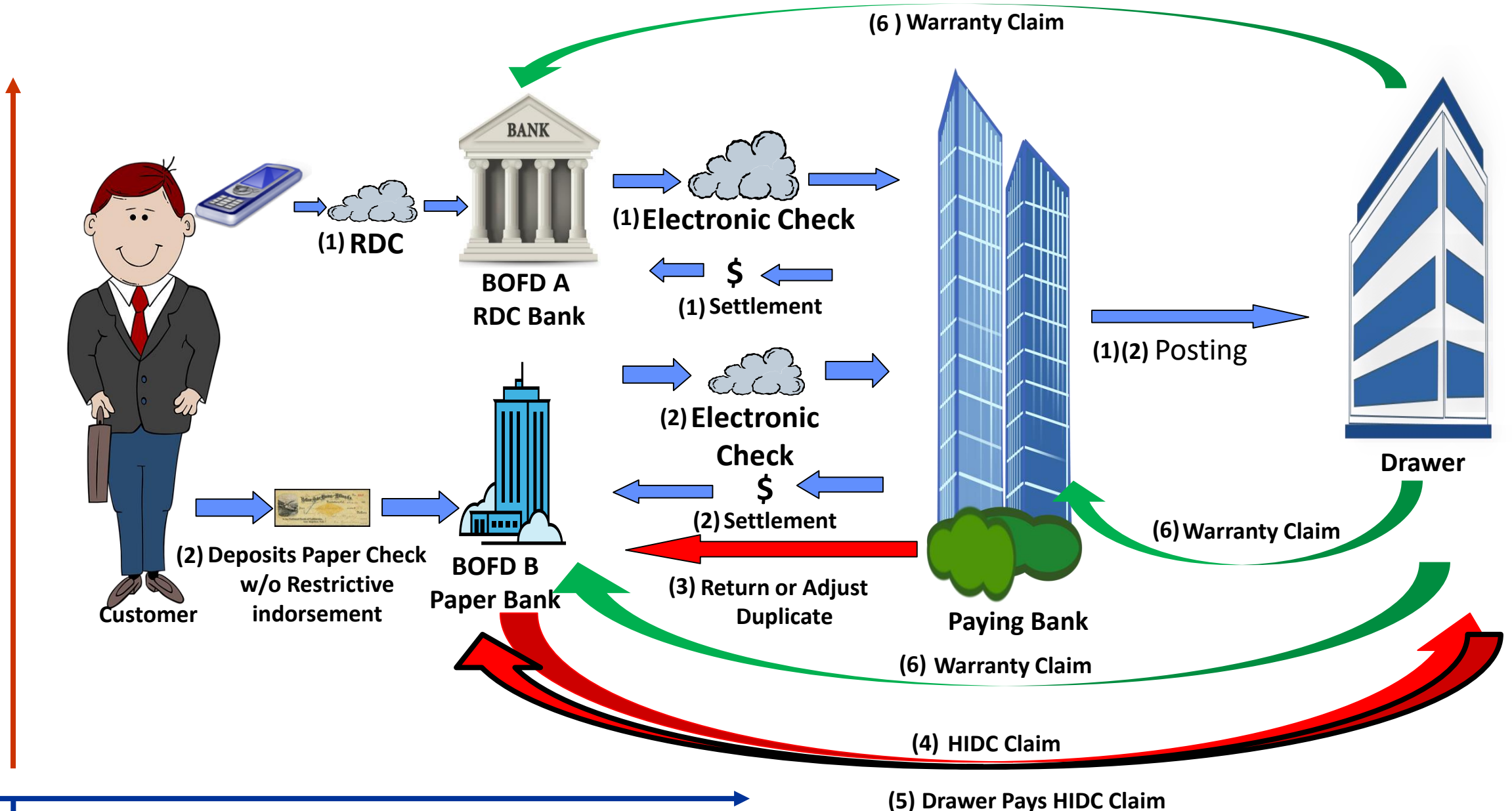
# Electronic Check Warranties



# Holder & Holder In Due Course

- **Holder: Person that comes into possession of negotiable instrument**
- **Holder in Due Course (HIDC) means holder of instrument if:**
  - Instrument does not bear apparent evidence of forgery or alteration or item calls into question its authenticity
    - ✓ Instrument is not overdue (i.e. 90 days after its date)
  - Accepted instrument
    - ✓ For value
    - ✓ In good faith
    - ✓ Without notice signature was unauthorized or item was altered
    - ✓ Without notice of claims against the item
- **Holder may make claim against drawer regardless of certain defenses**
  - Holder can enforce item against drawer
    - ✓ Even if item was returned unpaid by drawee (Paying Bank)
  - Not every holder qualifies as “holder in due course”

# HIDC and Electronic Check Warranties



# New Indemnity Remote Deposit Capture



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# RDC Indemnity

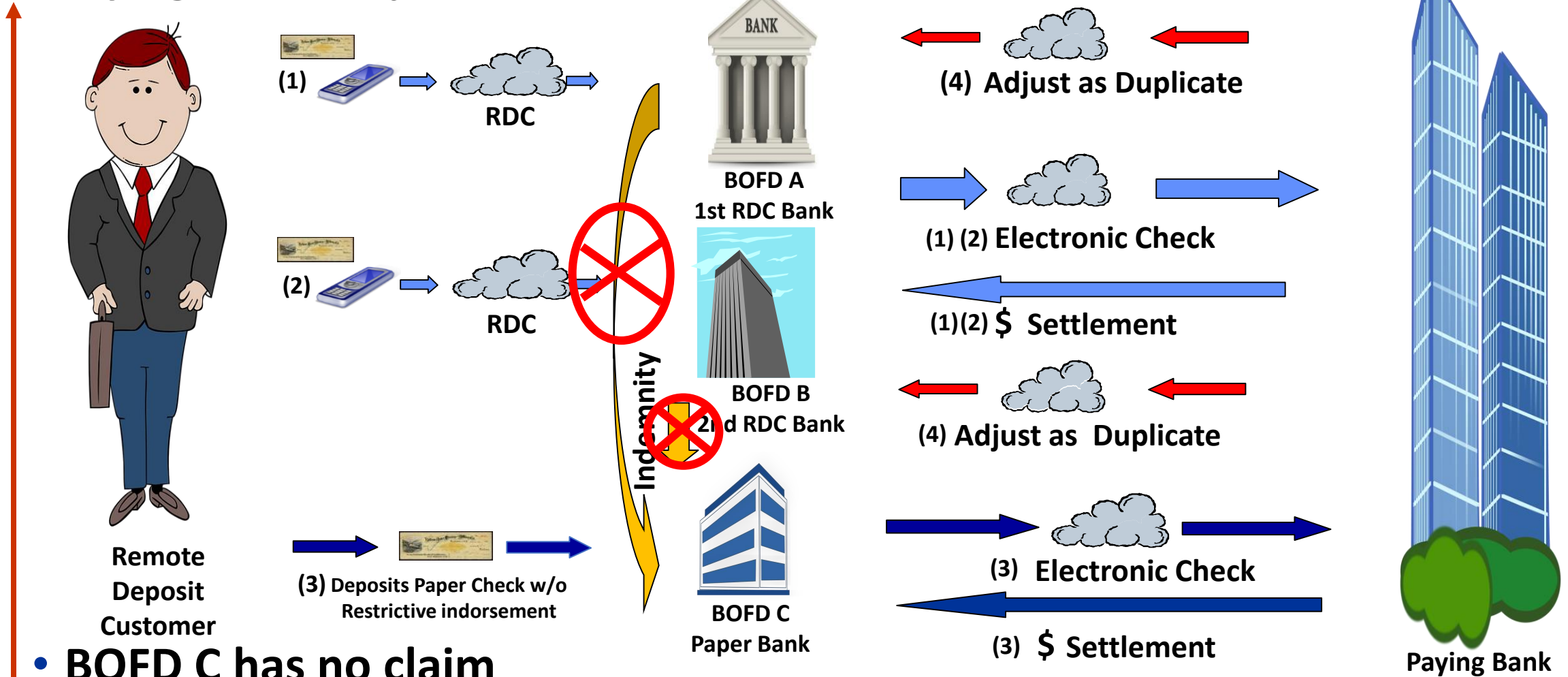
- **New Indemnity added to amended Reg CC**
- **Purpose of Indemnity:**
  - Provides some protection to subsequent depository bank that receives deposit of *paper check*
  - RDC bank's potential liability arises when it permits customer to truncate check and deposit image of that check
    - ✓ Customer retains original check and may intentionally or mistakenly deposit paper check in another bank
- **Paying Bank's duplicate item decisioning process remains unchanged**
  - May return duplicate if timing permits
  - May adjust as a PAID or Duplicate adjustment type
  - May send return/adjustment *to either BOFD*
- **Following scenarios assume Paying Bank decides to adjust unless specially identified in scenario**
  - Analysis may be different when returned in certain scenarios
  - Scenarios assume three banks – two RDC and one paper bank

# Conditions for RDC Indemnity

- **RDC Bank makes indemnity (4 conditions must be met):**
  - Truncating bank because it accepts deposit of electronic image/information related to original check;
  - Does not receive original check;
  - Receives settlement/consideration for electronic check/substitute check that is related to original check; and
  - Does not receive return of check unpaid
- **Paper Deposit Bank can enforce indemnity (4 conditions must be met):**
  - There must be an RDC Bank
  - Incurred a loss due to duplicate item
  - Must have received original paper check for deposit
  - Original check must not have a restrictive indorsement inconsistent with paper deposit

# RDC Indemnity

- Paying Banks adjusts to BOFD A and BOFD B



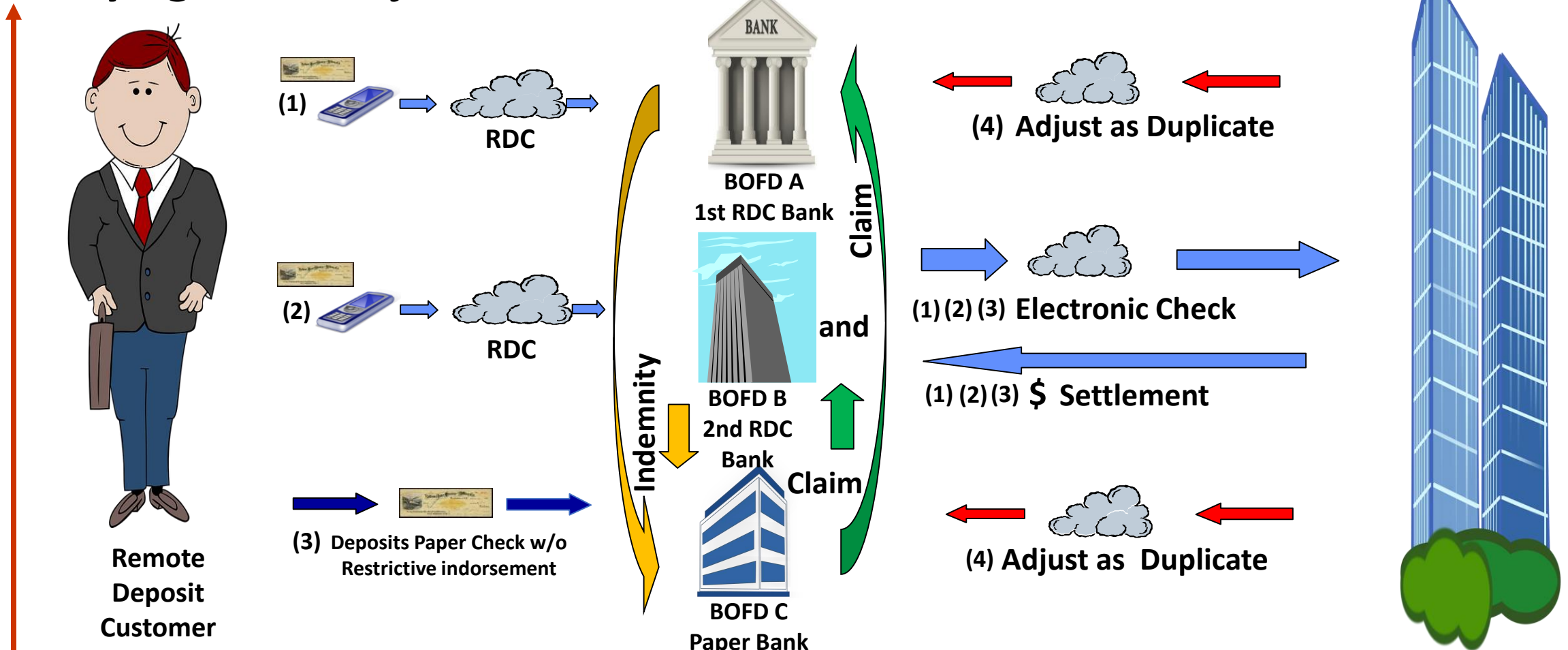
- **BOFD C has no claim**

➤ BOFD A and BOFD B have no recourse to any bank under Reg



# RDC Indemnity

- Paying Banks adjusts to BOFD A and BOFD C



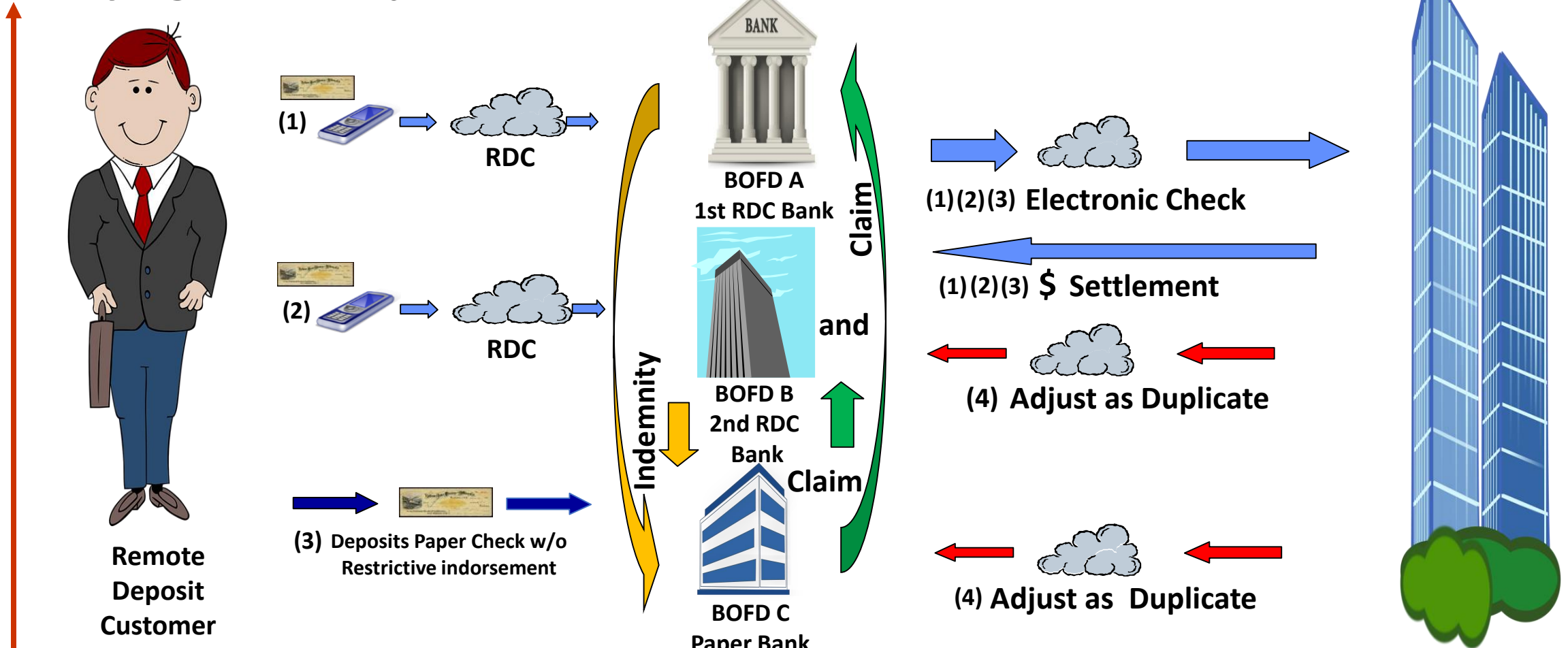
- BOFD C can make indemnity claims to BOFD A and BOFD B

➤ Can only receive payment from one bank



# RDC Indemnity

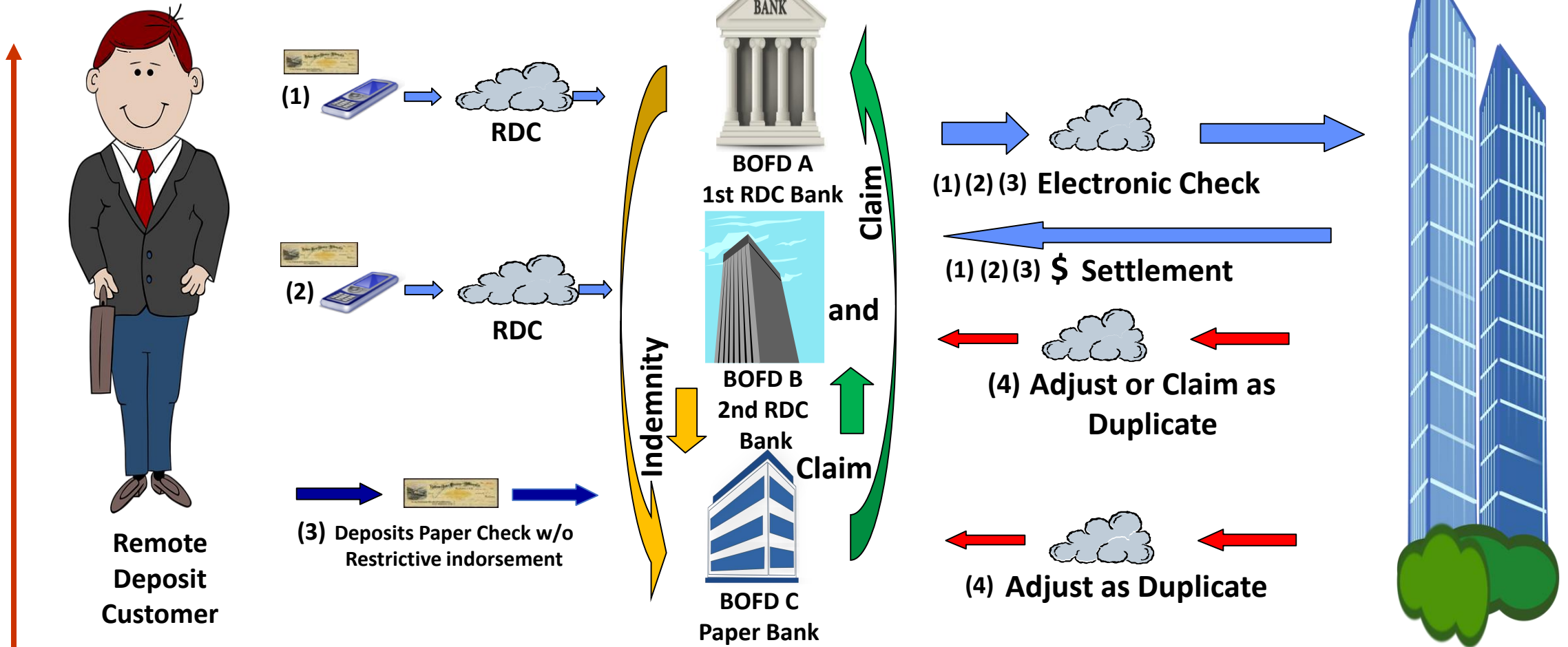
- Paying Banks adjusts to BOFD B and BOFD C



- BOFD C can make indemnity claims to BOFD A and BOFD B

➤ Can only receive payment from one bank

# RDC Indemnity – Double Jeopardy



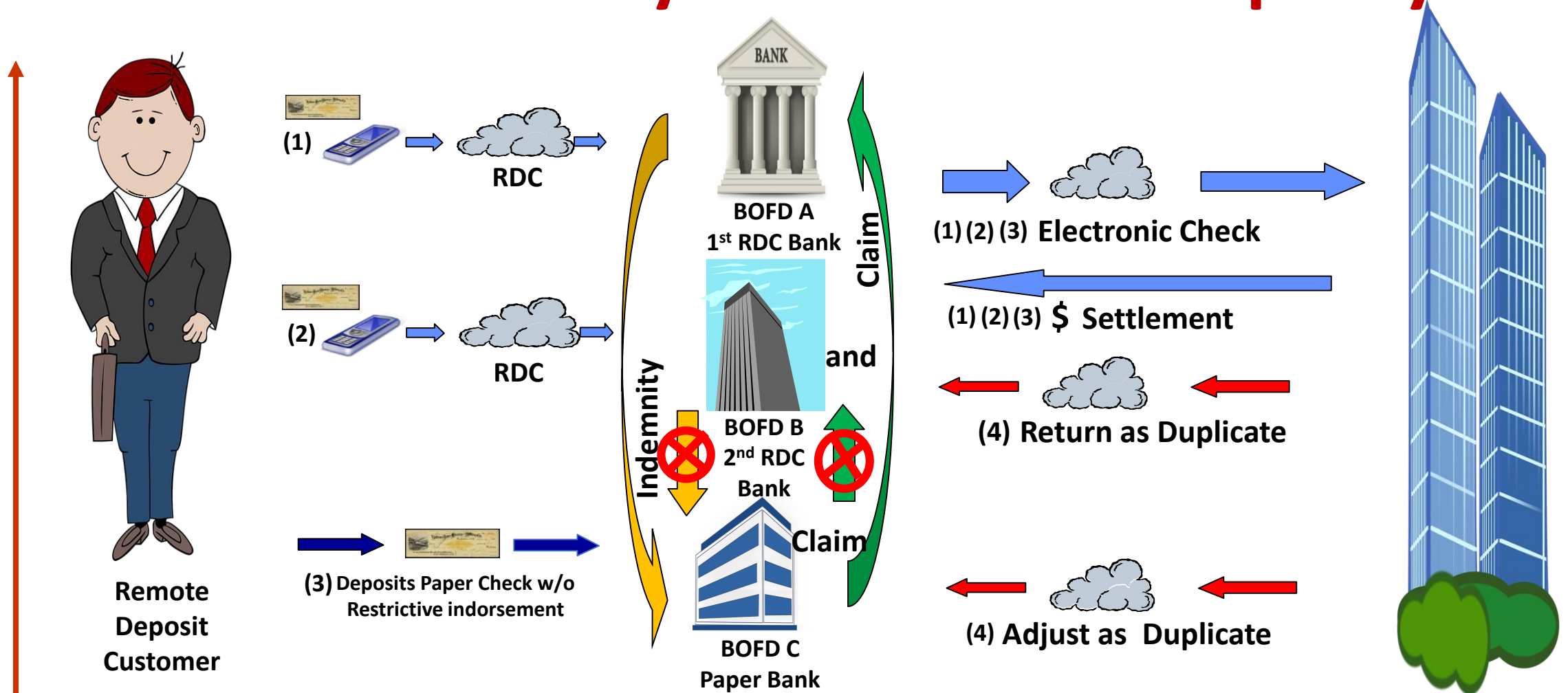
• Is BOFD B liable to BOFD C since it paid claim to Paying bank?

➤ Yes!

# RDC Indemnity

- **Is BOFD B liable to BOFD C since it paid claim to Paying bank**
  - Yes
- **Federal Reserve Board response**
  - RDC indemnity provided by depository bank when the four requirements met including
    - ✓ Depository bank receives settlement or other consideration
    - ✓ Does not receive return of check unpaid
  - Depository bank that accepted check via RDC that was adjusted as warranty claim would still satisfy these requirements
- **Assuming other requirements of indemnity provision satisfied, then bank indemnifies depository bank that accepts original check for deposit**
- **Board intends to continue to monitor use of indemnity and consider whether conditions warrant further action**
  - Fed did not receive comments on this scenario or frequency, interested in prevalence of situation
- **Industry may readdress this issue with Fed**

# RDC Indemnity – No Double Jeopardy



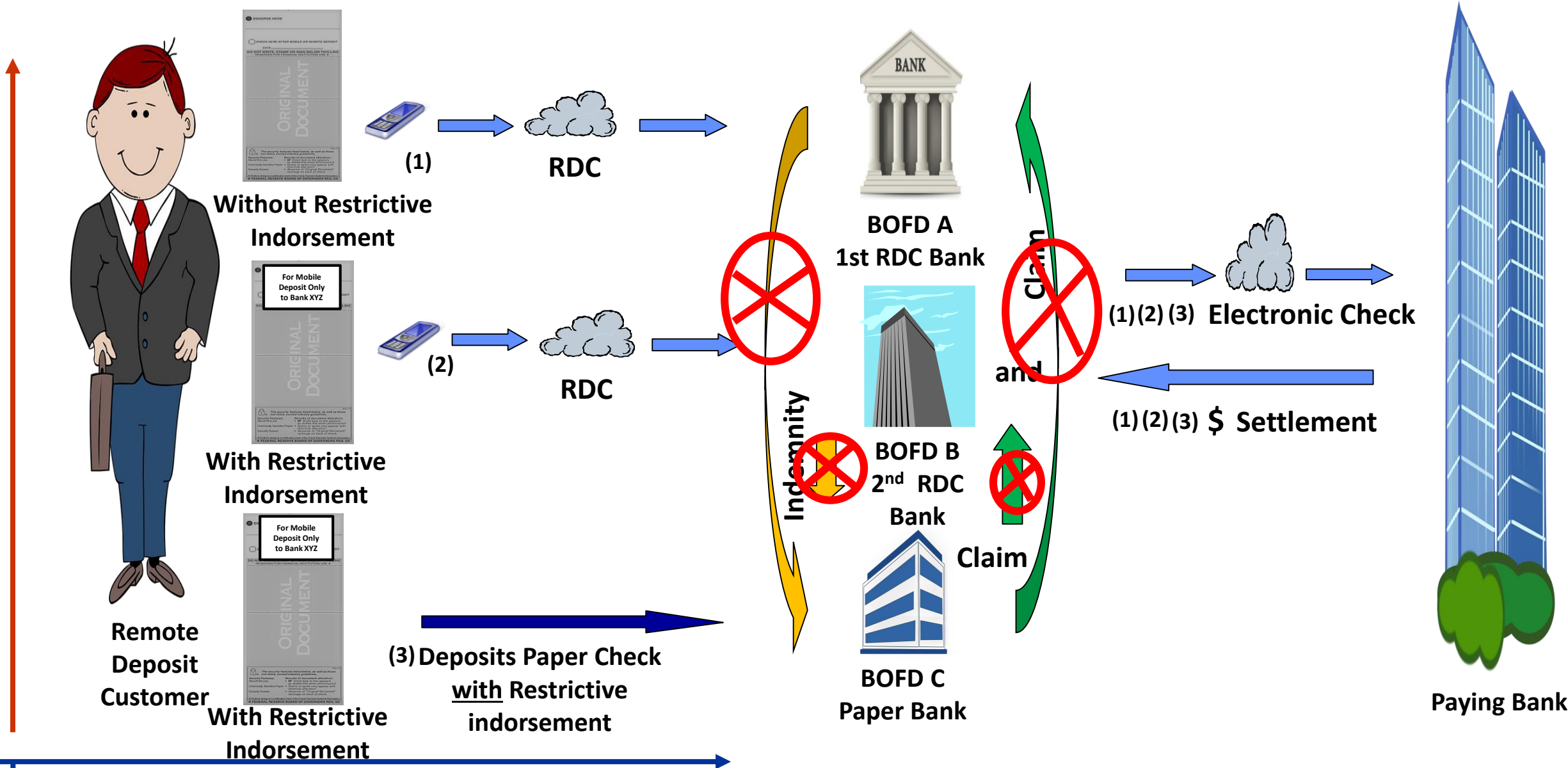
• Is BOFD B liable to BOFD C since item returned?

➤ No!

# RDC Indemnity

- **Under Regulation four conditions for RDC Indemnity**
- **RDC Bank (4 conditions must be met):**
  - Truncating bank because it accepts deposit of electronic image/information related to original check;
  - Does not receive original check;
  - Receives settlement/consideration for electronic check/substitute check that is related to original check; and
  - **Does not receive return of check unpaid**
- **Since item returned in previous scenario**
  - Indemnity not made by BOFD B

# When to Apply Restrictive Indorsement



# When to Apply Restrictive Indorsement

- **Restrictive Indorsement must be on check when deposited at Paper Bank**
  - Regulation does not say has to be on check when deposited at RDC bank
  - Paper Bank cannot make Indemnity claim when restrictive indorsement present on check
- **BOFD A may benefit from restrictive indorsement that was applied after it was deposited at BOFD A**

# Statute of Limitations



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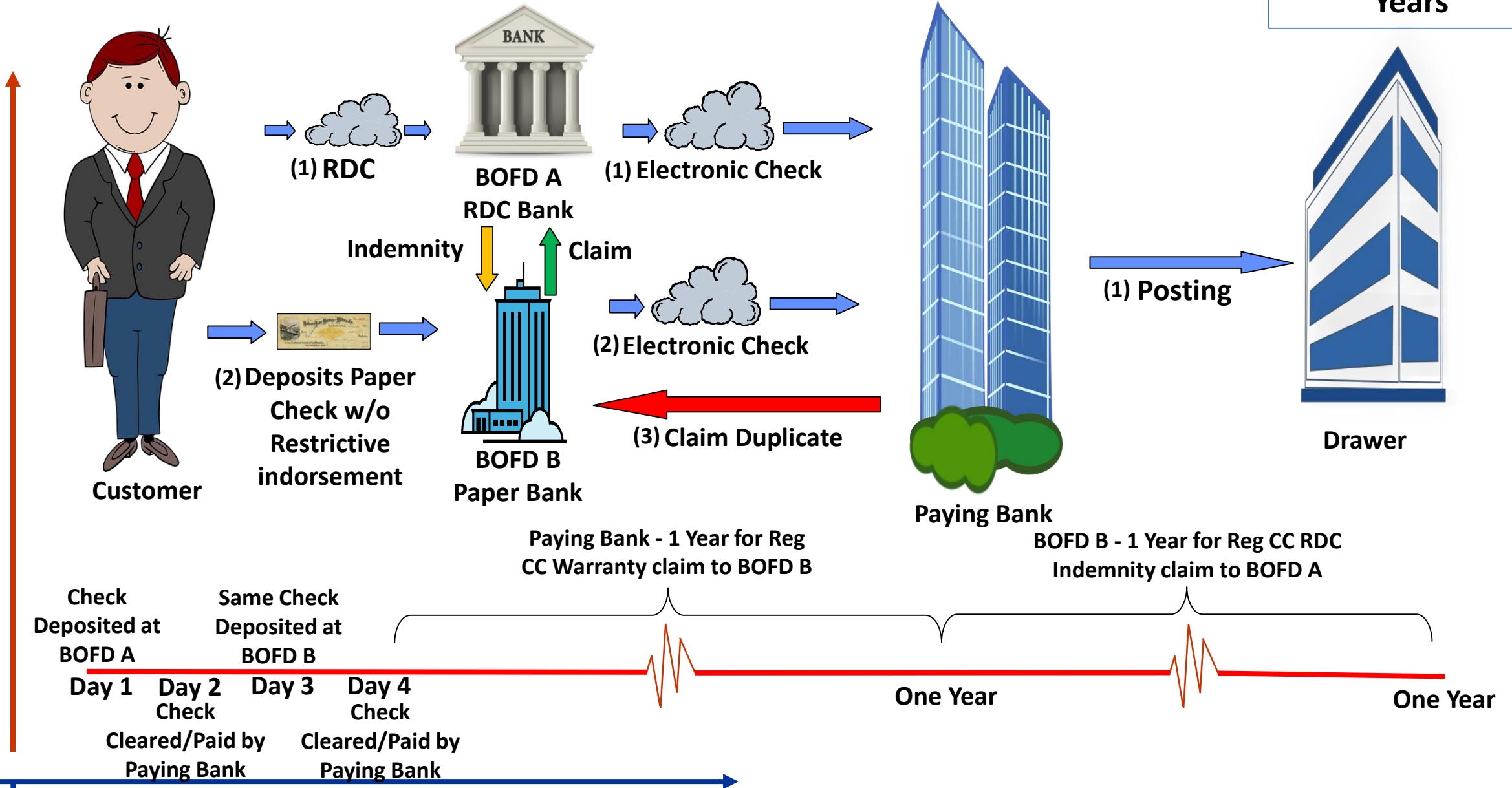


# Statute of Limitations

- **Regulation CC allows action brought within 1 year after date of occurrence of violation**
  - Similar provision in UCC allows 3 years after dishonor or 10 years from date of check, whichever period expires first
- **Statute of limitations are not necessarily the same timeframes as adjustment and return deadlines**

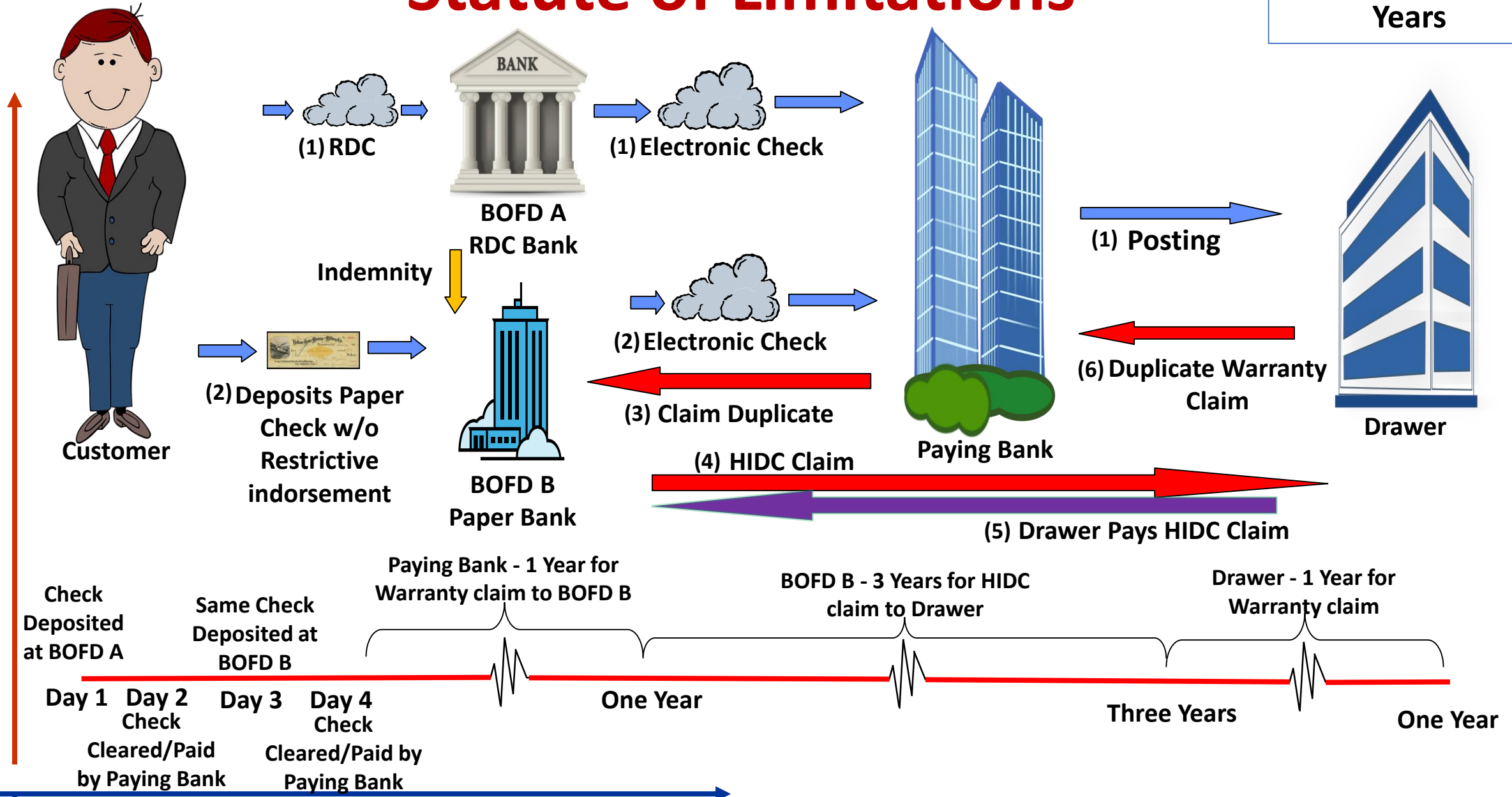
# Statute of Limitations

Potentially 2+ Years



# Statute of Limitations

Potentially 5+ Years



# Reminder

- **Should you or your company require legal counsel, you should consult with a competent attorney!**

# Conclusion

- These are examples of some potential scenarios
- As industry gains more experience with new provisions, new and interesting/challenging scenarios will emerge
- While this presentation has focused on potential considerations which might be perceived as negative:
  - Across the industry there has been relatively few issues
  - But those issues tend to be more difficult to resolve because:
    - ✓ They are issues new to adjustment personnel and
    - ✓ They are relatively more complex
- **RDC is a valuable service for customers!**


# Follow-Up

- **This session may qualify for NCP credits check with ECCHO at [ncpc@eccho.org](mailto:ncpc@eccho.org)**
  - In the case it does
    - ✓ Session length – 60 minutes
    - ✓ Session description
      - The Federal Reserve issued its final rule for Regulation CC in May 2017 effective July 2018. Since May 2017, the industry has updated Rules, agreements and implemented new processes and software, as appropriate. Now that the new provisions are in effect, it is time to start thinking about and analyzing possible real life scenarios. This session will explore the potential impact of various scenarios under the new Regulation CC modifications. This session will investigate scenarios involving the new Electronic Check/Electronic Returned Check warranties, the Remote Deposit Capture (RDC) Indemnity and Statute of Limitations as they relate to the Regulation and the interplay between Reg CC and the Uniform Commercial Code (UCC). Attendees should have a general understanding of the UCC and the updated Regulation as specific modifications to the Regulation will be discussed only as they relate to specific scenarios. Join this fun, interesting session and participate in thought provoking scenarios.
    - ✓ Keep copy of the file for your records
- **This session will be posted to [www.tillereendeavors.com](http://www.tillereendeavors.com) in a few days**

# Wrap-Up and Questions



# Thank You!



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# Acronyms & Terms Review

- **BOFD – Bank of First Deposit**
- **BOFD A – 1st Bank of First Deposit in an RDC duplicate presentment scenario**
- **BOFD B – 2nd Bank of First Deposit in an RDC duplicate presentment scenario**
- **CFPB – Consumer Financial Protection Bureau**
- **ECCHO – Electronic Check Clearing House Organization**
- **FRB - Federal Reserve Banks – propagates regulations and processes check, ACH and Wire Transfer**
- **MICR – Magnetic Ink Character Recognition**
- **Paper Deposit Bank – Bank accepting paper check for deposit in RDC indemnity scenario**
- **Reg CC – Regulation CC**
- **RDC – Remote Deposit Capture**
- **RDC Bank – Bank truncating a check via remote deposit in an RDC indemnity scenario**
- **RDC Indemnity – New in Reg CC to provide protection in certain conditions for depository bank that accepted deposit of paper check and then experienced a loss**
- **UCC – Uniform Commercial Code**