



Navigating Changes to Reg CC



What is Reg CC - Background

Expedited Funds Availability Act (EFAA) passed in 1987 to address concerns regarding the length of time financial institutions were placing holds on checks deposited by their customers/members and to foster improvements in the check collection and return process.

As part of the EFAA, Regulation CC implements the funds-availability and disclosure provision.

Reg CC was updated in 2003 with the passage of the Check Clearing for the 21st Century Act (Check 21).



What Changed?

Amendments to subparts A, C, and D of Regulation CC

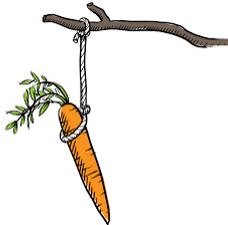
- Subpart A of Regulation CC contains general information, such as definitions of terms.
- Subpart C of Regulation CC implements the EFA Act's provisions regarding forward collection and return of checks.
- Subpart D of Regulation CC addresses electronic collection and the creation of 'substitute checks'.



What Changed?

In the final rule, the Board modified the current check collection and return requirements to reflect the virtually all-electronic check collection and return environment.

They were also attempting to encourage all depository banks to receive, and paying banks to send, returned checks electronically.



What Changed?

For paper checks, the current same-day settlement rule is unchanged.

The rule now applies Regulation CC's existing check warranties under subpart C to checks that are collected electronically.

In addition, the rule has adopted new warranties and indemnities related to checks collected, and returned, electronically and to electronically-created items.



Electronic Check – Paper Check

In the new rule the terms “electronic check” and “electronic returned check” are now defined as an electronic image or electronic information related to a check or returned check.

Such items will be treated as if they were checks applying the provisions of subpart C.



Return Requirements

Originally Regulation CC required a paying bank that determines it will not pay a check to return the check expeditiously.

These return requirements were originally implemented when check collection and return was largely paper-based and no longer reflects the way checks are being handled in today's environment.



Poll Question 1



Return Requirements

Now the process is almost entirely electronic. By the beginning of 2017 the Federal Reserve Banks received and presented over 99.99 percent of checks electronically.

This mostly electronic environment offers lower costs, faster returns, and fewer errors, which substantially reduces risk to the check system compared to the previous largely paper-based environment.



Expeditious Returns

The Board has required all returned checks, both paper and electronic, to satisfy a modified version of the “two-day test.” So that the check would normally be received by the depository bank not later than 2 p.m. (local time of the depository bank) on the second business day following the banking day on which the check was presented to the paying bank.



Expeditious Returns

The paying and returning banks may only be held liable for failing to return a check expeditiously if the depository bank has arrangements in place to receive the return electronically, directly, or indirectly.

The burden of proof lies with the depository bank to demonstrate that they have commercially reasonable means to accept a returned check. This is meant to encourage banks to process electronically.



Midnight Deadline

The midnight deadline is midnight of the banking day following the banking day the check is presented for payment. So, if a check is presented for payment on Monday, the payor bank must either pay it or return it by midnight Tuesday.

The updated rule allows for extension of the deadline for return to the time of dispatch only if the returned check or notice is *actually* received by the depository bank within the specified timeframe. Under the proposal, returned checks and notices must be received by the depository bank or receiving bank on or before the receiving bank's next banking day following the midnight deadline by the earlier of the close of that banking day or a cutoff hour of 2 p.m. or such later time as set by the receiving bank.



Alteration vs. Forgery

Under the Uniform Commercial Code (UCC), an alteration is a change to the terms of a check that is made after the check is issued that modifies an obligation of a party by, for example, changing the payee's name or the amount of the check.

A forgery is a check on which the signature of the drawer (*i.e.*, the account-holder at the paying bank) was made without authorization at the time of the check's issuance.

Typically the *depository bank bears the loss related to an altered check* and the *paying bank bears the loss related to a forged check*.



Presumption of Alteration

The presumption of alteration applies to a dispute between banks where an electronic check or a substitute check was transferred between those banks.

The presumption applies in such a dispute regardless of where in the chain, or by whom, the original check was truncated.

However, presumption does not apply to a dispute between banks where the original check was transferred between those banks, even if that check is subsequently truncated and destroyed.



Presumption of Alteration

When a paying bank receives presentment of the original check, the presumption of alteration would not apply, as the presumption applies only to disputes concerning substitute checks or electronic checks.

The rule only applies to disputes between financial institutions. Disputes involving an individual claimant would not be covered by this presumption.



Poll Question 2



Electronic Check Warranties

The existing paper-check and Check-21-like warranties will now cover the electronic checks.

Paper check warranties include the returned-check warranties; the notice of nonpayment warranties; the settlement amount, encoding, and offset warranties; and the transfer and presentment warranties related to a remotely-created check.



Electronic Check Warranties

Check-21-like warranties include warranties that a bank will not be asked to pay an item twice and that the electronic image and electronic information are sufficient to create a substitute check. These warranties ensure that a bank that receives a check for collection, presentment, or return receives the same warranties regardless of whether the check is in paper or electronic form.



Electronically Created Item

What is meant by the term electronically created item (ECI)?

The rule defines it as “an electronic image that has all the attributes of an electronic check or electronic returned check but was created electronically and not derived from a paper check.” These items never existed in paper form and are not considered electronic checks and would not be subject to most provisions of Reg CC.



Electronically Created Item Indemnity

A bank transferring an image or information that is *not* derived from a paper check (*i.e.*, an electronically-created item) indemnifies each 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.



Notice of Non-Payment

Old Rule: Notice required from paying bank to Bank Of First Deposit (BOFD) for an item to be returned in the amount of \$2,500 and over by 4:00 PM on the second business day after presentment.

New Rule: Notice required from paying bank to BOFD for an item to be returned in the amount of **\$5,000** and over by **2:00** PM on the second business day after presentment.

The time is determined as local time for the depository bank.



Notice of Non-Payment

Required Contents of the Notice now include:

- Bank name
- RTN and trace or sequence number associated with Bank Of First Deposit
- Name of Payee
- Amount
- Date of indorsement of Bank Of First Deposit
- Reason for nonpayment



Notice in Lieu

Reg CC previously provided that, if a check is unavailable for return, the paying bank may send in its place a copy of the front and back of the returned check, or, if no such copy is available, a written notice of nonpayment, or notice in lieu, could be issued.

The rule has changed to reflect the same requirements for a notice in lieu and a notice of nonpayment.

The information needed is the same for both notices.



Identification of a Returned Check

In providing clarity to the reason for return, the new rule revises the term face of the check to read front of the check.

Paying banks are directed to clearly indicate on the front of the check that it is being returned and the reason for return. In instances when an item has already been paid, refer to maker is not a permissible reason for return. However, it may be used in a situation where a drawer with a positive pay arrangement instructs the financial institution to return the check.

When returning either a substitute check or an electronic check, the specific reason for return must be included on any subsequent substitute check.



Poll Question 3



RDC Indemnity

The final rule adds a new indemnity for remote deposit capture that would indemnify a depository bank that received a deposit of an original paper check that was returned unpaid because the check was previously deposited using a remote deposit capture service and paid.

This creates a concern that remote deposit capture or mobile deposit services may be impacted. Financial institutions would potentially be discouraged from offering those services.



Restrictive Indorsement

In response to concerns raised by commenters prior to the adoption of the final rule, the Board has added an exception to the indemnity that would prevent an indemnified bank from making an indemnity claim if it accepted an original check containing a restrictive indorsement that is inconsistent with the means of deposit, such as “for mobile deposit only.”



Restrictive Indorsement

It is very important that financial institutions update their remote and mobile deposit policies and disclosures to clearly state the requirements for the indorsement on the back of check being deposited remotely.



Impacts for Your Credit Union

Policies and procedures – are they current?

Disclosures, signage, policies – are they accurate?

Training for all related staff – is it effective?

<https://www.federalregister.gov/documents/2017/06/15/2017-11379/availability-of-funds-and-collection-of-checks>



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