The Clearing House®

X9 Standards Update
EPC, RCCs and Return Reasons:
What, Where and Why

September 26, 2019

2 pm ET/ 1 pm CT / 11 am PT

Webinar/Conference call

DISCLAIMER

- The information contained herein has been prepared for education and general informational purposes only and is not offered as and does not constitute legal advice or legal opinions.

- You should not act or rely on any information contained herein without first seeking the advice of your legal counsel.

- The comments today are those of the presenters and not necessarily those of JPMorgan Chase, The Federal Reserve Bank or The Clearing House or ECCHO membership.

ASC X9

- Payments Standards developed and available for purchase through the accredited standards body for financial services:

  - Accredited Standards Committee (ASC) X9, Inc.

  - X9 creates American National Standards (ANS)

    - X9 is accredited by American National Standards Institute (ANSI)

  - Please visit the website for additional information www.X9.org

Today's Speakers

- Mark Kielman, Operations Director

    Retail Payments Office; Federal Reserve Bank – Atlanta

- Jackie Pagan, Vice President

    Regulations, Standards, & Industry Relationship Manager; JPMorgan Chase

- Ellen Heffner, Director

    NCP Program Manager; ECCHO, a Service of The Clearing House

Agenda

- Remotely Created Check (RCC) and External Processing Code (EPC)

  - Definitions

  - Usage and Benefits

- Reg CC and X9 Standards Updates

- Q&A

- Appendix A

Remotely Created Checks
&
External Processing Code

Level-set on Terms

- ***Remotely Created Check (RCC)***
  - Defined in Reg CC as a check that:
    - Is not created by the paying bank; and
    - Does not bear a signature applied, or purported to be applied, by the person on whose account the check is drawn (unsigned draft)
  - Paper instrument that contains an unconditional written order instructing drawee (paying bank) to make payment to the order of designated payee

Level-set on Terms

- ***EPC: External Processing Code***

  – Defined in standard ANS X9.100-160-2

  – Location: MICR field 6, position 44 on MICR line

  - To the immediate left of routing number

  – Discreet code used to collect data

  – EPC value = '6'

  - Used to identify a remotely created check

Why a Unique Code for RCCs?

- RCCs vulnerable to fraud because:
  - Do not bear drawer's signature, or
  - Readily verifiable indication of authorization
- Consumer/bank complaints of alleged fraud with RCCs
  - Unauthorized RCCs create risk & cost to FIs
- Reg CC places liability for unauthorized RCCs on bank that transfers or presents the item [§229.34(b)]
  - Bank that **transfers or presents** a remotely created check and receives a settlement or other consideration warrants:
    - Person on whose account the remotely created check is drawn authorized the issuance of the check:
      - In the amount stated on the check; and
      - To the payee stated on the check

Why a Unique Code for RCCs?

- Using EPC identifier, FIs may identify and track these items

- May choose to track are report:

  – Which customers routinely create these

  – How many are disputed as unauthorized

  – Are there any fraud losses related to RCCs

  – Other considerations

    - Potential regulatory need in the future:

      – Federal Trade Commission (FTC) outlawed RCCs for telemarketing

      – Telemarketing Sales Rule (TSR) stated there's no way to monitor these items

      – Recent ruling in Ohio case included additional statements from FTC about inability of FIs to monitor these items

Benefits

- Discreet code offers opportunity to collect data

- Offers a monitoring mechanism to confirm RCC is:

  —Authorized

  —Generated by the Payee

  —Processed to the paying bank for collection

- Track usage, customer behavior and trends such as:

  —Presentment volumes

  —Return rates

  —Specific account activity to identify potential fraud

How are Remotely Created Checks Used?

- RCC is an unsigned draft authorized by account holder
  - Contains a MICR line exactly the same as any check
    - Making value of '6' available in existing EPC field
  - Processed through the banking system as a check
- RCCs serve useful business purposes such as:
  - "Just in time" payments or internet payments
- Examples that follow illustrate business-size and consumer-size RCCs showing location of the EPC identifier

Samples with EPC '6' value

Business-size Check

RCC Identification

Not Signed by Drawer

Consumer Check

RCC Identification

Not Signed by Drawer

Sample IRD with EPC value '6'

011500120
01/04/2002
8587408979

This is a LEGAL COPY of your check.
You can use it the same way you
would use the original check.

I800539446   01/03/2002
[053000183]

NAME OF COMPANY
STREET ADDRESS
CITY, STATE

101

00-6789/0000

DATE   12-5-09

PAY TO THE
ORDER OF _____ Payee's Name _____ $ 123.45

One hundred twenty-three and _____ 45/100 Dollars

Financial Institution Name
Street Address
City, State

Memo _____

Authorized by Drawer   MP

⑈000001 0 1⑈ 6⑆00006 7894⑆ 1 2345678⑈

⑈00000 0 1 0 1⑈ 4⑆00006 7894⑆ 1 2345678⑈   ⑈0000012345⑈

IRD
Identification

RCC Identification

EPC code '6' Available

- Effective November 2015 – X9 provided widely available training prior to its implementation

  - Several financial institutions and processors have implemented

- To adopt, review payments systems and make required updates:

  - *Issuers:* Add value '6' in EPC field for RCCs

  - *Financial institutions:* Recognize EPC value to identify and analyze RCC activity and trends

Getting Started

- Do you have customers that issue RCCs?

  – Consider working with your legal staff to update account holder agreements to require use of '6' in EPC code when generating RCCs

  – Determine what data you want to track:

    - How many RCCs are flowing through your systems?

    - How many are being paid vs. returned?

    - Are RCCs contributing to fraud losses?

Regulation CC
and
X9 Standards

Reg CC – Changes to Indorsement Obligation

- Revisions to §229.35 – indorsement requirements now apply directly to electronic checks/electronic returned checks

  - Indorsement obligations for electronic checks imposed by provisions of Regulation CC

  - 2018-2019 updates eliminated Appendix D – Indorsement, Reconverting-Bank Identification and Truncation Bank Identification Standards

    - Refers to X9 industry standards for indorsement for paper checks, substitute checks and electronic checks

- Following are highlights of related X9 standards updates

ANSI X9 Updates

- Standards updated to conform with Reg CC changes:

  - X9.100-111 – Check Endorsements

  - X9.100-140 – Image Replacement Document (IRD)

  - X9.100-188 – Return Reasons for Check Image Exchange and IRDs
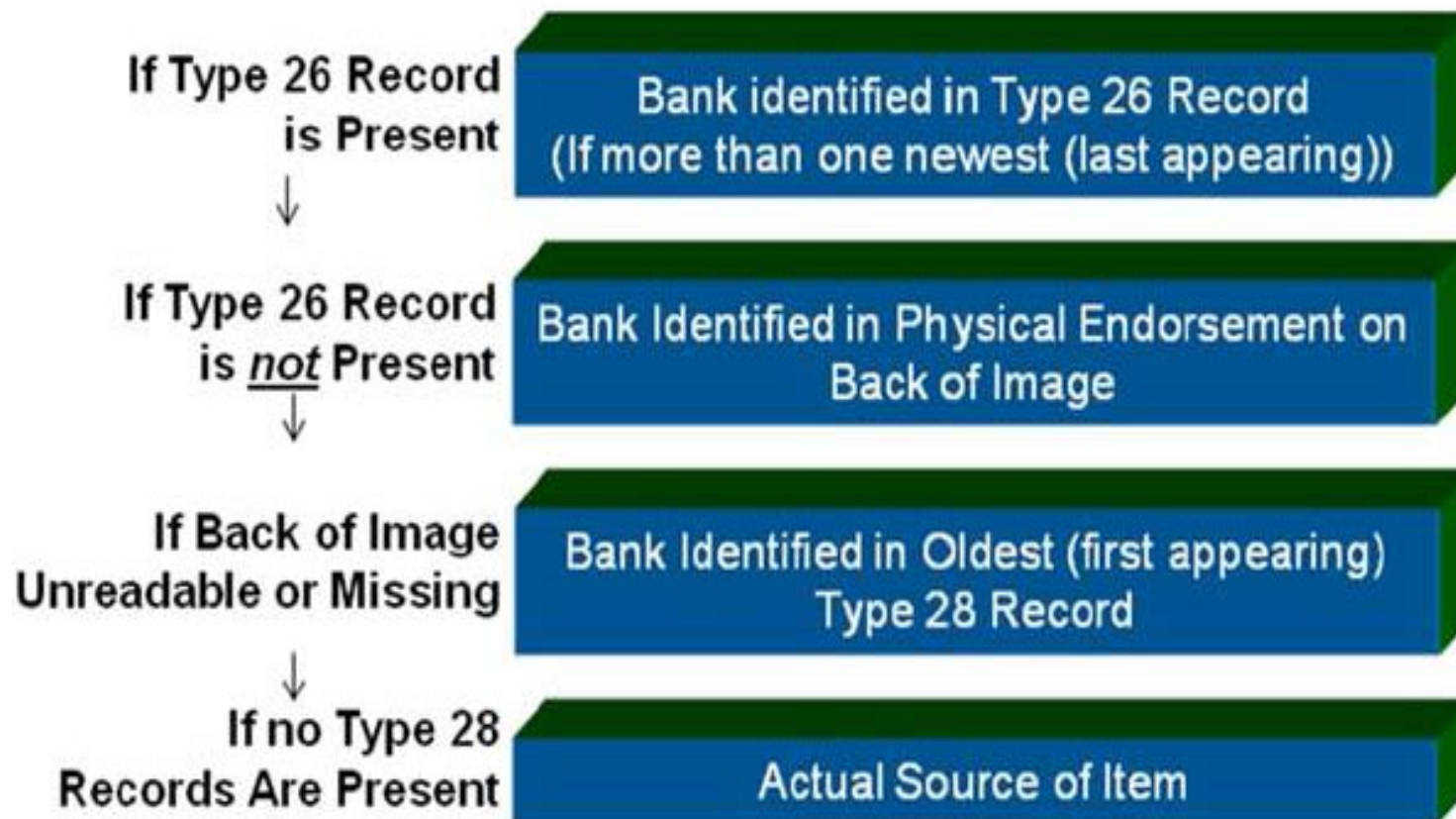
- Will discuss each briefly

X9.100-111: Check Endorsements Standard

- Added supplemental information related to restrictive payee endorsements; See Annex A – Implementation Considerations
  - Paper Depositary Bank cannot make warranty claim if physical check it received for deposit bore restrictive indorsement inconsistent with means of this deposit
  - Reg CC commentary provides illustrative examples of restrictive endorsements for RDC items
    - Example provided:
      - "For mobile deposit at [name of first depositary bank] only"
  - Other examples:
    - "For electronic deposit only at [name of first depositary bank] only"
    - "For remote deposit at [name of first depositary bank] only"
- FIs should consult with legal counsel to determine best approach

X9.100-111: Check Endorsements Standard

- ECCHO Return Item Decision Hierarchy

  - Information captured in Annex B − Return Item Hierarchy: Relationship Between Physical Endorsement and Electronic Endorsements

If Type 26 Record is Present ↓	Bank identified in Type 26 Record (If more than one newest (last appearing))
If Type 26 Record is _not_ Present ↓	Bank Identified in Physical Endorsement on Back of Image
If Back of Image Unreadable or Missing ↓	Bank Identified in Oldest (first appearing) Type 28 Record
If no Type 28 Records Are Present	Actual Source of Item

X9.100-140: Substitute Check/IRD Standard

- Added references for IRD creation for rejected checks

  - Definition of term "reconverting bank" added to:

    - Clarify that identification is required by a paying bank, or a bank, that rejects a check submitted for deposit and instead of the original check, sends an IRD back to its customer (e.g.; deposited check rejected at ATM)

  - Bank still makes the Check 21 warranties

- References to Regulation CC Appendix D removed

X9.100-188: Return Reasons

- Updates to terminology to reflect definition changes in other standards
  - To maintain consistency across standards
- Recent Updates
  - **'P' – Item Outside of Stated Dollar Amount Limit**
    - Expanded to include "over and under" allowable amount
      - Prior description: Exceeds stated max value
      - New description: Item outside of stated dollar amount limit
  - **'S' – Refer to Maker**
    - Language added to clarify usage
      - Excerpt from X9.100-188 Annex A:
        - This return reason code may be appropriate when a maker with a positive pay arrangement instructs the bank to return the check. This reason code would be inappropriate in cases when the check is being returned due to the paying bank having already paid the item (duplicate presentment), where a check has been altered, or where a check is unauthorized.

Return Reasons for Check Image Exchange and IRDs

X9.100-188-2018

Warranty Breach – Return Codes

- '3' – Warranty Breach

  - Can be used for various warranty breaches:

    - Rule 8 & 9 claims

  - Must be under ECCHO Rules agreement to use for Rule 8 & Rule 9 claims

    - Note: Rule 8 and Rule 9 claims are ***not*** sent to Fed

Warranty Breach – Return Codes

- '4' – RCC Warranty Breach
  - Used only for Rule 8 claims - process for unauthorized RCCs
  - Uses the return mechanism but is **not a return;** Rule 8 is a breach of warranty claim
  - Must be under agreement that provides for this claim (ECCHO Rules)
  - May **not** be used for returns through Fed
  - Different from return code 'Q' which can be used without a specific rule set
  - Code '3' can also be used for Rule 8 claim
- Same meaning for customer or admin returns

Warranty Breach – Return Codes

- '5' – Forged/Counterfeit Warranty Breach
  - Used for Rule 9 claims - warranty breaches in which 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
  - Uses the return mechanism but is **not a return;** Rule 9 is a breach of warranty claim
  - Must be under ECCHO Rules agreement, exchange occurred under ECCHO Rules, and neither party opted out of using Rule 9
  - May **not** be used for returns through Fed
  - Code '3' can also be used for Rule 9 claim
- Same meaning for customer or admin returns

Questions?

Standards and Technical Reports

- Visit the X9.org website at www.x9.org
  - X9.100-111 – Check Endorsements
  - X9.100-140 – Image Replacement Document (IRD)
  - X9.100-187 – Electronic Exchange of Check and Image Data
  - X9.100-188 – Return Reasons for Check Image Exchange and IRDs
  - TR 47 Universal Companion Document
- *Note: X9.100-188 available free of charge; other standards and reports may be ordered*

Thank You!

Jackie Pagán, NCP
Vice President
JPMorgan Chase & Co
jackie.m.pagan@jpmchase.com

Mark Kielman
Operations
Federal Reserve Bank Atlanta
Mark.A.Kielman@atl.frb.org

Ellen Heffner, NCP

Director

ECCHO|The Clearing House

eheffner@eccho.org

APPENDIX A

Customer Return Reason Codes
&
Administrative Reasons for Return

Appendix A: Acronyms

- Rule 8 – Warranty for Remotely Created Checks

  – See ECCHO Rules for Rule 8/RCC Warranty - Section XIX (N)

- Rule 9 – Warranty for Forged & Counterfeit Checks

  – See ECCHO Rules Section XIX(O)

- TR 47 – Technical Report 47 (designation for UCD)

- UCD – Universal Companion Document

- UCC – Uniform Commercial Code

- X9 – Payments-related standards group

Appendix A: Customer Returns (Alpha Order)

- 'A' NSF – customer does not have sufficient funds to cover item

- 'B' UCF – uncollected funds hold

- 'C' Stop payment – a stop payment has been placed on the item

- 'D' Closed account – the item's account has been closed

- 'E' UTLA – unable to locate account

- 'F' Frozen/blocked account – account has restrictions placed by customer or bank

- 'G' Stale dated – the date on the item is more than 6 months old

- 'H' Post dated – the date on the item is in the future

- 'I' Endorsement missing

- 'J' Endorsement irregular

Appendix A: Customer Returns (Alpha Order)

- 'K'   Signature(s) missing
- 'L'   Signature(s) irregular, suspected forgery
- 'M'   Non-cash item (non-negotiable)
- 'N'   Altered/fictitious item/Suspected counterfeit/Counterfeit
- 'O'   Unable to process
- 'P'   Item Outside of Stated Dollar Amount Limit
- 'Q'   Not authorized RCC
- 'R'   Branch/account sold (Wrong Bank)
- 'S'   Refer to Maker
- 'T'   Item cannot be re-presented (exceeds allowable number of presentments)
- 'U'   Unusable image

Appendix A: Customer Returns (Alpha Order)

- 'W'   Cannot determine amount

- 'X'   Refer to image – return reason is contained within the image of the item

- 'Y'   Duplicate presentment

- 'Z'   Forgery – affidavit shall be available upon request

- '3'   Warranty breach (includes Rule 8 & 9 claims)

- '4'   RCC warranty breach

- '5'   Forged and counterfeit warranty breach (Rule 9)

- '6'   Retired/ineligible routing number

Appendix A: Admin Return Reasons

- 'I' Image Missing
- 'Q' Ineligible Item
- 'T' Item cannot be re-presented (exceeds number of allowable times for presentment)
- 'U' Unusable image
- 'V' Image fails security check
- 'Y' Duplicate presentment
- '1' Does not conform with ANS X9.100-181
- '2' Does not conform to the Industry's Universal Companion Document
- '3' Warranty Breach (includes Rule 8 & Rule 9 claims)
- '4' RCC Warranty Breach (Rule 8)
- '5' Forged and Counterfeit Warranty Breach (Rule 9)
- '6' Retired/Ineligible Routing Number