

Checks – Is it a Return? An Adjustment? Or do we Deal Direct?

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Learning Objectives



- Differentiate between check returns and adjustments
- Identify when to handle issues through direct dealings
- Apply UCC Article 4 and Regulation CC requirements
- Navigate compliance and regulatory considerations

- Check Returns Framework
- Check Adjustments
- Direct Dealings
- Practical Scenarios

Talking Points

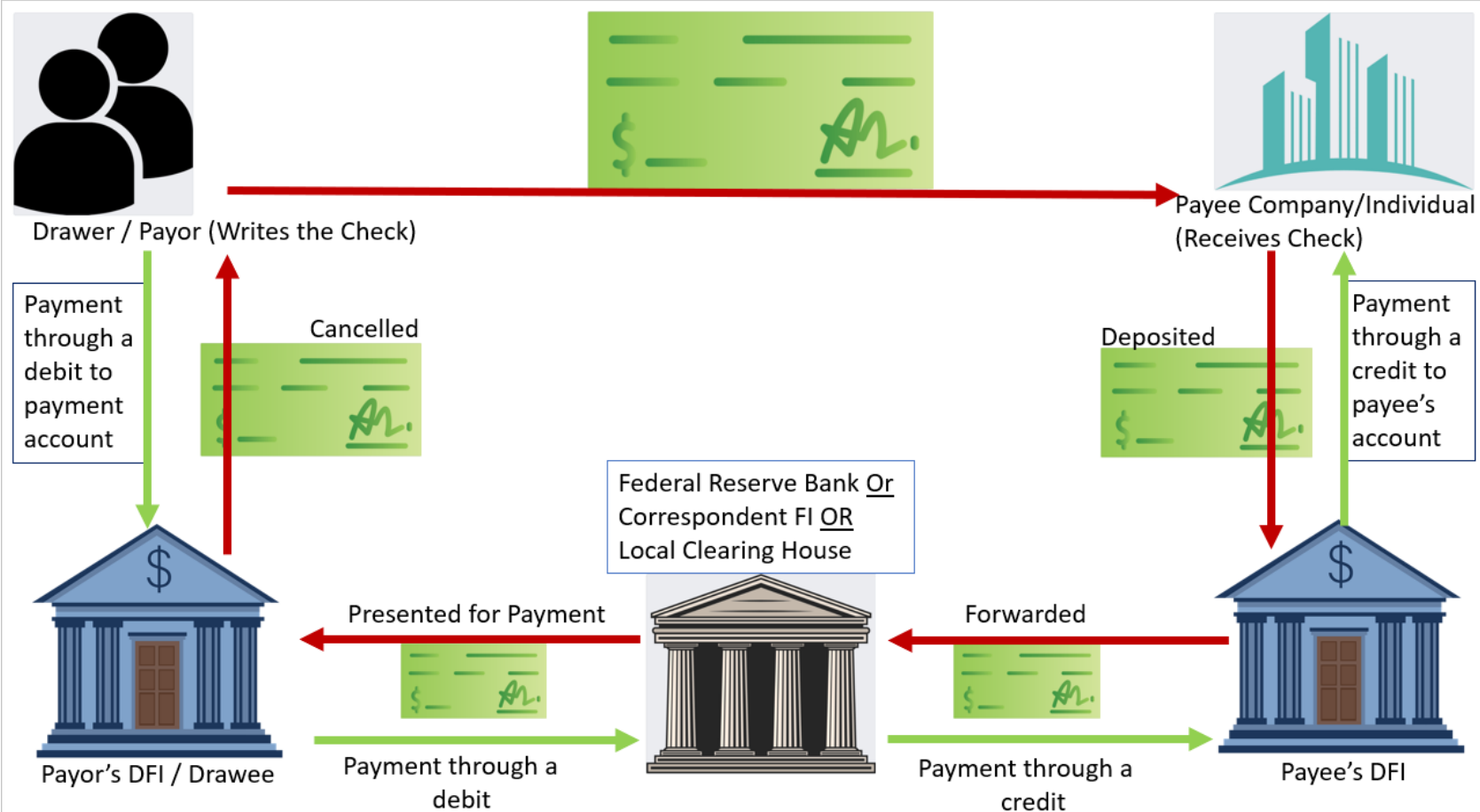


The Check Collection Process

Depository FI – where the check is first deposited. UCC also calls Bank of First Deposit or BOFD

Intermediaries, such as Correspondent FI, Local Clearing House, or Federal Reserve

Payor FI – FI on which check is drawn. UCC also calls Paying Bank.



UCC Articles 3 & 4

Art. 3: Negotiable Instruments — defines checks, holder in due course, signatures

Art. 4: Bank Deposits & Collections — midnight deadline, warranties, return obligations

§4-301: Midnight deadline rule — return by midnight of next banking day

§4-207/4-208: Transfer & presentment warranties

Regulation CC (12 CFR Part 229)

Subpart B: Expedited funds availability rules

§229.31: Paying FI's return obligation — expeditious return standard

§229.32: Depository FI must accept returned checks

§229.34: Warranties including "no double debit" protection

Fed Operating Circular 3 (OC3)

Governs FRB handling of cash items and returned checks. Section 20 covers exceptions & adjustments.

§20.13: Prohibits sending post-deadline items through cash/return letters to pursue warranty claims.

Check 21 Act & ECCHO Rules

Check 21: Authorizes substitute checks (IRDs); image exchanges require separate bilateral agreements

ECCHO: Electronic Check Clearing House Organization rules governing image exchange and warranties, including Rule 9

The Regulatory Framework

Check Returns – understanding the types, timing rules, and proper procedures when a paying FI decides not to pay

UCC MIDNIGHT DEADLINE

Midnight – Return Initiated

Next banking day after presentment


UCC §4-301 — If check presented Monday, return by midnight Tuesday. Failure = FI is "*accountable*" for the item. Applies to virtually all check returns.

REG CC EXPEDITIOUS RETURN

2:00 PM – Return Received

2nd business day after presentment (BOFD local time)

Reg CC §229.31 — Amended from 4:00 PM to 2:00 PM cutoff. Paying FI may avoid liability for late return if BOFD lacks electronic return capability.

 **Critical Rule:** A paying FI that misses the midnight deadline may be held **accountable** for the check — meaning it cannot dishonor the item. The Reg CC "2nd business day" standard addresses expeditious routing, not the pay/return decision itself.

Return Codes – A Sampling

X9.100-187 Standard — Items charged to a customer account. Paying bank must clearly indicate reason on front of check (Reg CC requirement).

A - NSF	B – UCF	C – Stop Payment	D – Closed Account
E – Unable to Locate Account	F – Frozen Account	G – Stale Dated	H – Post Dated
I – Indorsement Missing	J – Indorsement Irregular	L – Suspected Forgery / Signature Irregular	N – Altered / Counterfeit / Fictitious Item

Return Routing & Qualified Returns

How Returns Travel (Reg CC §229.31)

- ▶ Paying bank may send directly to BOFD, OR through any bank that agrees to handle the return
- ▶ If paying bank cannot identify BOFD, it may send to any bank that handled forward collection
- ▶ Reg CC eliminated requirement to follow exact forward collection chain — allows more direct routing
- ▶ BOFD must accept returned checks at branch, head office, or processing center and pay by close of business

Qualified Return Checks

Paying bank encodes in MICR:

- ① Routing number of BOFD
- ② Amount of returned check
- ③ "2" in position 44 (original check) or "5" (substitute check) — the return identifier

Encoded per **ANS X9.13** standards

Electronic Returns: Reg CC amendments incentivize electronic returns. Paying bank protected from liability for late electronic return IF BOFD does not have commercially reasonable electronic connection in place.

Check Adjustments

- When the return window has closed — how to recover funds and resolve **settlement errors** through the Federal Reserve



What is a Check Adjustment?

Definition

A check adjustment is a formal request to **resolve a debit or credit settlement discrepancy** on a check that has already been sent for collection and processed — often after the return window has closed.

Adjustments are the **primary recovery tool** when timing has eliminated the normal return path.

Adjustments vs. Returns

Returns: Paying bank dishonors and returns check — within the midnight/Reg CC deadline window

Adjustments: Discrepancy discovered after processing — may adjust partial amounts. Most common: encoding errors, duplicate presentments, late return claims

Key difference: Adjustments can credit **partial** amounts; returns are for the full item.

ENC

Encoding Error

Use when: Item encoded for an amount different from the legal (written) amount.

Example: Check written for \$500 but encoded as \$50 — submit ENC for a *credit* of \$450.

Reverse scenario: submit ENC for a *debit* of \$450.

Reporting Timeframes:

✓ Within 6 months → Same-day entry

⚠ 6–12 months → Acknowledge only; advise to deal directly

DUP

Duplicate Entry

Use when: You receive two identical adjustment entries from the Federal Reserve for the same transaction — request reversal of the duplicate.

Note: DUP does NOT apply to paid items charged twice in a cash/return letter — use PAID ITYP for that scenario.

Reporting Timeframes:

✓ Within 20 business days → Same-day entry

⚠ 20 days–1 year → Entry after notice to offsetting institution

Key Investigation Types (ITYPS)

Required fields for ALL adjustment requests: Sender ABA + contact info, Receiver ABA (FRB), Case Investigation Type (ITYP), Case Amount, Entry Type (Credit/Debit), Sender Reference Number (SREF)

LC - Late Return Claim

Filed by: BOFD / Depository Bank

Claims that the check was returned LATE by the paying bank — after the Reg CC expeditious return deadline.

BOFD must demonstrate financial loss from the late return. Submit with supporting documentation to FRB.

LR - Late Return Disclaimer

Filed by: Paying Bank (Drawee)

Disputes the LC debit — asserts that the check WAS returned within the deadline. Must provide proof of timely return.

Requires: Paying Bank's Response to Claim of Late Return form + authorized signature.

LC/LR Timing Rules at a Glance


- ✓ LC within 6 months of return date → FRB makes entry
- ✓ LR within 20 business days of LC debit → Same-day entry
- ⚠ LC after 6 months → FRB advises direct dealing
- ⚠ LR after 20 days → No entry; advise direct dealing

Key Investigation Types (ITYPS)

NOI — Not Our Item: Submit within 20 business days when you receive an item in your return letter that belongs to another institution. Include source information on the sticker. Preferred method: Check Adjustment channels (electronic or paper).

Direct Dealings

When neither a return nor an FRB adjustment is available — protocols for direct FI-to-FI communication, warranty claims, and recovery

 **Federal Reserve OC3 §20.13 — Critical Prohibition:** An FI **MUST NOT** attempt to recover on a warranty or indemnity claim by including an item in a paper or electronic cash letter or return letter **after the return deadline**. Violation exposes the FI to liability.

- ① **Return deadline has passed** — After midnight deadline for counterfeit/forged maker signature items (ECCHO Rule 9 applies only if both FIs are ECCHO members)
- ② **Altered check breach of warranty** — BOFD warranted item was not altered at presentment (UCC §4-208). Not subject to midnight deadline — typically 1+ year per state law.
- ③ **FRB adjustment timeframe expired** — After 6 months (ENC) or after 1 calendar year from cash/return letter date for most ITYPs, FRB instructs institutions to deal directly
- ④ **FRB declines to make entry** — After FRB initial research period (20 business days), FRB may decline and advise "deal directly with offsetting institution"
- ⑤ **Forged indorsement recovery** — Paying FI may have a defense to a late return for forged indorsements; regardless, recovery against BOFD is pursued directly

When Must You Deal Directly?



UCC – Transfer & Presentment Warranties

UCC §4-207 — Transfer Warranties

Made by customer/collecting bank at each transfer for consideration. Flow from depositor → BOFD → each collecting bank.

- ▶ Warrantor is entitled to enforce the instrument
- ▶ All signatures are authentic and authorized
- ▶ **Item has not been altered**
- ▶ No defense or claim in recoupment against warrantor
- ▶ No knowledge of insolvency of maker/drawer
- ▶ For remotely created consumer item: authorized issuance

⚠ Transfer warranties do NOT extend to the drawee/issuing institution (cashier's checks)

UCC §4-208 — Presentment Warranties

Made at the time of presentment to the paying bank. Applies to unaccepted drafts (personal checks). Does NOT apply to cashier's checks (already accepted).

- ▶ Person is entitled to enforce the draft
- ▶ **Draft has not been altered**
- ▶ No knowledge that drawer's signature is unauthorized

30-Day Notice Rule (§4-207(d)): Claimant must notify warrantor within **30 days** after having reason to know of the breach and the warrantor's identity, or risk losing damages for the delay period.

Altered vs. Counterfeit

✓ ALTERED CHECK

Unauthorized change to an existing instrument (e.g., amount washed and rewritten, payee name changed).

-NOT subject to midnight deadline – deal direct

-Paying bank has a **breach of warranty claim** against BOFD

-Timeframe: State law — typically **at least 1 year**

-BOFD is liable *even if* no funds remain in the account

-(BOFD warranted item was not altered — regardless of account balance)

⚠ COUNTERFEIT / FORGED MAKER SIGNATURE

Fabricated check or unauthorized drawer signature (item never authorized by account holder).

-IS subject to midnight deadline

-After deadline, paying bank holds the warranty

-ECCHO Rule 9 provides post-deadline recourse:

— BOFD liable *only if sufficient funds* remain

— BOFD may charge back to depositing customer

— Cannot use Fed channel for claim after deadline (OC3 §20.13)

ECCHO Rule 9 – Forged & Counterfeit Warranties

What Rule 9 Does

Depository bank warrants to the paying bank that:

- ① The signature of the purported drawer is **NOT forged or unauthorized**
- ② The related physical check is **NOT counterfeit**

Allows paying bank to make a claim **AFTER** the midnight return deadline has passed.

When It Applies

- ▶ Both banks must be **ECCHO members**
- ▶ Counterfeit check OR forged maker signature
- ▶ Return deadline has already passed
- ▶ Customer often identified issue weeks after posting



ECCHO Rule 9 – Forged & Counterfeit Warranties

Liability Limits

BOFD is liable **only if sufficient funds remain** in the depositing customer's account at the time of the claim.

BOFD can then **charge back the item to its customer** — so theoretically no FI is left holding the loss from the fraud.

Process Overview

- ① Paying FI discovers issue after deadline
- ② Confirms ECCHO membership of BOFD
- ③ Files Rule 9 claim directly with BOFD
- ④ BOFD reviews available funds in account
- ⑤ BOFD pays if funds available; charges back customer





Compliance & Regulation

Documentation standards, consumer protections, communication obligations, and how to stay on the right side of the deadline

Compliance Obligations at Every Step

Return Documentation

- ▶ **Reg CC §229.31:** Clearly indicate "returned check" on front; state reason for return
- ▶ For substitute checks: place return info within the image on front
- ▶ Use correct X9 return reason codes — improper codes create liability
- ▶ Retain records of: presentment date, return date, return method

Communication Standards

- ▶ Direct warranty claims: use institution letterhead, cite specific UCC provisions

Accountability & Risk

- ▶ Missing midnight deadline = paying bank accountable for item
- ▶ Reg CC §229.34(a)(1)(ii): "No double debit" warranty — prevents charging a party twice
- ▶ Drawer precluded rule (UCC §4-406): drawer who fails to report unauthorized signature within statement cycle may lose recourse

Return? Adjust? Or Deal Direct?

Issue Discovered — What Do I Do?

✓ **RETURN** - Still within midnight deadline (UCC) AND 2nd business day (Reg CC). Use correct return reason code.
NSF · Stop Pay · Closed Acct · Stale Dated · Endorsement · Admin Codes

⚙️ **ADJUST (via FRB)** - Return window closed. Encoding error, duplicate, late return claim, or NOI.
Within FRB timeframes.

ENC (within 6 mo.) · DUP (within 20 days) · LC/LR · NOI · PAID ITYP

👊 **DEAL DIRECT** - Altered check warranty. Post-deadline fraud. FRB timeframes expired. FRB declines entry.
Altered check (§4-208 breach) · ECCHO Rule 9 · FRB "deal direct" instruction

Golden Rule: Always document the date you discovered the issue, the date of presentment, and every action taken. The difference between recovery and loss often comes down to **one business day**.

NSF Return



SCENARIO A — STANDARD RETURN

\$3,200 check — NSF

Situation: Check presented Monday 8 AM. Account has \$900. Paying bank identifies NSF during end-of-day processing.

Action: Return by midnight Tuesday using code "A" (NSF). MICR encode as qualified return with routing of BOFD. Indicate "RETURNED — NSF" on front of check.

Result: Timely return. Paying bank has no liability for the item. BOFD receives return by 2:00 PM Wednesday (Reg CC compliant).

FRB Adjustment



\$12,500 check — Encoding Error

Situation: Check was written for \$12,500 but was encoded as \$125,000. Discovered 3 weeks after processing — return window closed.

Action: Submit **ENC adjustment** through FedLine. Amount: \$112,500 debit. Provide front/back image copy. Submit within 6 months for same-day entry.

Result: FRB processes same-day entry of \$112,500 correction. Both institutions' settlement accounts adjusted.

\$900 → \$9,000 — Check Washed

Situation: Customer wrote \$900 check. Fraudster intercepted, washed, and re-wrote for \$9,000. Deposited at another institution. Paying bank customer discovers 45 days later — return deadline long past.

Action: DO NOT send back through Fed (OC3 §20.13 violation). Contact BOFD directly. File **Breach of Warranty claim** under UCC §4-208. Cite alteration; demand \$8,100. Include 30-day notice per §4-207(d).

Result: BOFD liable regardless of account balance. State statute of limitations applies (typically 1+ year). No need for funds to be present.

Altered Check (Direct)



\$4,500 — Counterfeit Check

Situation: Fraudster created a counterfeit check on paying bank's customer's account. Deposited at ECCHO-member BOFD. Customer notifies paying bank 3 weeks after the check cleared — deadline passed.

Action: Cannot use standard return or FRB warranty claim. Verify BOFD is ECCHO member. File **ECCHO Rule 9 claim** directly against BOFD.

Caveat: BOFD liable **ONLY** if sufficient funds remain in fraudster's account. If account drained, paying bank may absorb loss or pursue fraudster directly.

Counterfeit (ECCHO Rule 9)



Late Return Dispute



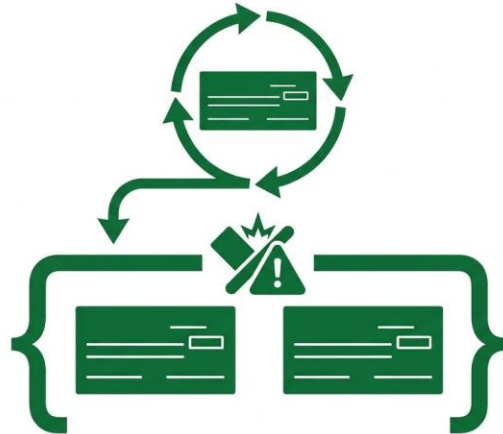
\$18,000 — Return Timing Dispute

Situation: Paying bank returned check claiming NSF. BOFD asserts return was received after 2:00 PM on the 2nd business day — late. BOFD files **LC (Late Return Claim)** against paying bank via FRB.

Paying bank response: Has proof of timely transmission. Files **LR (Late Return Disclaimer)** within 20 business days of the LC debit. Attaches Paying Bank's Response form with authorized signature + transmission records.

Key: Transmission logs, FedLine timestamps, and return letter confirmation are your evidence. Keep for at least 12 months.

Duplicate Presentment



\$2,750 — Check Deposited Twice

Situation: Customer deposited a check both via mobile RDC at BOFD-1 and then physically at a branch of BOFD-2. Both items cleared. Paying bank debited twice for the same check.

Action: If it's a duplicate cash letter ENTRY from FRB, submit **DUP ITYP**. If it's a second presentment of the same item as a separate cash item, paying bank can return using code **Q** (Ineligible) or may pursue directly against BOFD for indemnity under Reg CC §229.34's no-double-debit warranty.

RDC connection: BOFD that accepts an RDC deposit makes a "no double debit" warranty under Reg CC §229.34 — this is the key indemnity provision for duplicate items.

Best Practices, Part 1

Deadline Management

- ▶ Document presentment date on every item at receipt
- ▶ Use a deadline tracker: midnight deadline, Reg CC 2-day, Multi-day adjustment windows
- ▶ Set internal review at critical intervals after processing
- ▶ Keep FedLine/FRB/Correspondent transmission logs for minimum 12 months

Communication Protocols

- ▶ All direct bank communications in writing on institution letterhead
- ▶ Cite specific UCC sections and Reg CC provisions in claims
- ▶ Follow up verbal contacts immediately with written confirmation
- ▶ Maintain contact database for check operations at peer institutions

Best Practices, Part 2

Key Reference Resources

- ▶ FRB Check Adjustments QRG — frbservices.org
- ▶ Federal Reserve Operating Circular 3 (OC3)
- ▶ Regulation CC Compliance Guide — federalreserve.gov
- ▶ ECCHO FAQs & Rule 9 — theclearinghouse.org/ECCHO
- ▶ ANSI X9.100-188 Return Reason Codes — x9.org

Fraud Prevention Tips

- ▶ Implement Positive Pay for business accounts — help to catch altered payee/amount
- ▶ Utilize MICR line anomaly detection during processing
- ▶ Train staff on check washing indicators (blurring, shine, ink offset)
- ▶ Monitor unusual deposit patterns at RDC points for dual-deposit risk

- 1 Timing is everything.** The midnight deadline (UCC §4-301) and Reg CC 2-day expeditious return standard define your window. Miss them and your options narrow dramatically.
- 2 Know your ITYP options.** ENC, DUP, LC, LR, NOI — each FRB adjustment type has specific timeframes, required fields, and documentation. The FRB Check Adjustments QRG is your go-to reference.
- 3 Altered ≠ Counterfeit.** Altered checks = breach of warranty claim against BOFD. Counterfeit/forged maker = midnight deadline applies; use ECCHO Rule 9 only if both banks are members and funds remain.
- 4 OC3 §20.13 is absolute.** Never send a post-deadline item through a cash/return letter to pursue a warranty claim. You must deal directly with the BOFD — or use ECCHO Rule 9 if eligible.
- 5 Document everything.** Every date, every contact, every transmission. Your documentation is the difference between winning and losing a warranty claim — or recovering from a fraudulent check.

Key Takeaways

Navigate with Confidence

You now have the framework to clearly distinguish between check returns, adjustments, and situations requiring direct handling — and the regulatory foundation to act decisively, accurately, and compliantly. Ask yourself – is it a Return? An Adjustment? Or do we Deal Direct

Returns

Timely · Coded · Expeditious

Adjustments

ENC · DUP · LC/LR · NOI

Direct Dealings

Warranty · ECCHO Rule 9 · Bank-to-Bank



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