

The Electronic Check Clearing House Organization (ECCHO)

Rules Summary

Overview of ECCHO and the ECCHO Rules

This document provides an overview and summary of ECCHO and the ECCHO Rules. It is not intended as a definitive guide to the ECCHO Rules, and a Member should consult the full text of the ECCHO Rules in the event of a question regarding the application of the ECCHO Rules to a specific transaction.

1. General Structure of ECCHO and the ECCHO Rules

ECCHO is a check clearinghouse whose membership consists solely of U.S. depository institutions. The ECCHO Rules are clearinghouse rules under the Uniform Commercial Code (“UCC”). As clearinghouse rules, the terms of the ECCHO Rules may vary provisions of the UCC with respect to a person interested in a check processed under the clearinghouse rules. (See Section II(B) of the Rules). As a national clearinghouse, ECCHO seeks to facilitate the exchange of electronic check transactions between depository institutions of all sizes throughout the United States.

While the Rules provide a legal framework for the exchange of electronic check transactions, both check images and electronic check presentment notices, the Rules also recognize and build upon existing check law, such as the UCC and Regulation CC of the Federal Reserve Board.

Each specific ECCHO Rule includes a related Commentary section that further describes the intended purpose of the Rule, the possible application of the Rule to various hypothetical situations, and additional implementation issues for consideration by Members in complying with the specific Rule.

A Member of ECCHO is not permitted to use (whether by private agreement of the parties or otherwise) the ECCHO Rules to attempt to govern an electronic check transaction between the Member and a non-Member entity. The ECCHO Rules, as clearing house rules applicable only to members of the clearinghouse, only govern electronic check transactions between two Members. (See Section II(A) of the Rules).

Changes to the ECCHO Rules are approved by the Board of Directors of ECCHO from time to time. The Board receives input on suggested changes from the Operations Committee of ECCHO, individual Members, and Sponsoring Organizations. Changes to the ECCHO Rules are binding on all Members of ECCHO, as of the effective date established by the Board upon approval of the Rule.

2. Types of Member Institutions in ECCHO

There are different classes of ECCHO Members under the Bylaws and Rules. The classes of membership are Full Members, Affiliated Members, Participating Members and Sponsored Members. The different classes of membership reflect variations in Members' corporate governance roles and participation in ECCHO committee structures. For example, Sponsored Members do not have direct representation on the Board of Directors, and may interact with ECCHO (such as participation in the Operations Committee and other workgroups of ECCHO) primarily through their sponsoring organizations. All ECCHO Members have the same rights and responsibilities under the ECCHO Rules with respect to electronic check transactions that are exchanged between the Members. (See Sections II(D) through II(H) of the Rules).

3. Member Agreement Prior to Exchanges of Check Images

Prior to engaging in an electronic check transaction with one or more other Members, a Member must have the agreement of the other Member with which it seeks to undertake an exchange. A Member is not required, by virtue of its membership in

ECCHO, to receive or send electronic check transactions with another Member. However, if a Member agrees to exchange electronic check transactions under the ECCHO Rules with another Member, the exchanging Members must comply with the ECCHO Rules for those electronic check transactions. An agreement between Members can take different forms, including bilateral arrangements, agreements through check networks/archives, and agreements created by processors acting as agents of the Members. (See Commentary to Section XIX(C) of the Rules).

A Member must provide written notification to other Members when seeking to discontinue exchanges of electronic check transactions under the ECCHO Rules. ECCHO also may notify Members and Sponsoring Organizations of the change in membership status of Members. (See Section II(C) of the Rules).

A Member must establish the technological and communication methods for exchanging electronic check transactions with another Member. For example, two or more Members could agree to use a particular electronic communications switch or a check image archive to exchange electronic check images. These Member agreements are sometimes referred to as banking practices agreements (“BPAs”), and in many cases the BPAs are established by the networks or archives through which Members exchange electronic check transactions. These technical and procedural matters are the responsibility of the Members, as opposed to the ECCHO Rules, because these types of issues are unique to Members’ operational systems, processes and schedules. For example, a Member needs to specify the receipt deadlines and electronic delivery locations for electronic check transactions for its exchanges with other Members.

4. Member’s Relationship With Its Depositing Customer or Drawer Customer

The ECCHO Rules do not expressly address the treatment of check image transactions or other electronic check transactions between a Member and its customers (both drawer customers and depositing customers). Rather, the relationship of a Member

and its customer is governed by applicable law and the deposit agreement or other check processing agreement in place between a customer and a Member. For example, if a Member permits its customer to remotely image paper checks and submit those images to the Member for processing, the ECCHO Rules do not address the responsibility or rights of the customer and/or the Member in that transaction. However, the Member would be responsible to other Members for any check image that the Member sends to another Member, even if the check image was created by the customer of the first Member. To assist Members with customer implementation issues, the exhibits to the ECCHO Rules include sample customer agreement language for certain aspects of electronic check transactions.

5. Electronic Check Image Forward Presentment and Return

The ECCHO Rules provide the legal framework for both forward check image presentment and return of a check image. A Member may select which of these types of electronic check transactions supported under the ECCHO Rules it will exchange with other Members. Even if a Member has elected to exchange check images with a Member, it is not obligated under the Rules to send check images in the return process. A Member may phase in the two types of transaction over a period of time.

6. Electronic Image Exchange

The ECCHO Rules establish rules for the exchange of an electronic check image of a paper check (an “Electronic Image”) between two ECCHO Members. In an exchange under the ECCHO Rules, both the Electronic Image and the related MICR line information are sent or made available to the receiving Member. The MICR line information for a particular Electronic Image is referred to in the ECCHO Rules as the “presentment notice,” and is transmitted either with the Electronic Image or within a certain time period of the sending of the Electronic Image.

An ECCHO Member is responsible for informing other Members (typically in the banking practices agreement, discussed above) of the electronic locations and relevant daily cut-off times for the transmission or other delivery of Electronic Images and the related presentment notices. The ECCHO Rules are independent of any specific image exchange switches or networks, and provide sufficient flexibility for Members to designate locations and processing cut-off times for exchanges through different electronic switches or networks.

When Members exchange Electronic Images, the paper check is not sent to the receiving Member after the Electronic Image is sent. Rather, the receiving Member uses the information from the Electronic Image (and the related presentment notice) to make the payment or return decision and to post the check to the account of the drawer customer. The Electronic Image replaces the original check. In order to support the processing of the Electronic Image as the original check, the ECCHO Rules provide that the Electronic Image is an “item” and a “check” under the UCC and Regulation CC, respectively. (See Section XIX(F) and Section XX(E) of the Rules). For example, this means that the requirements under the UCC and Regulation CC for timeliness of processing and return of paper checks applies equally to receipt of an Electronic Image.

At least one electronic indorsement for an Electronic Image is required under the ECCHO rules regardless of whether a written indorsement has been placed on the related physical check. The Sending Bank is required to provide an electronic indorsement to indicate that it is either the Depository Bank or the Collecting Bank. If the Sending Bank is the Depository Bank, it is required under the Rules to identify itself as such in an electronic indorsement. If the Sending Bank receives an image containing electronic indorsement(s), the Sending Bank must include those indorsement(s) when sending the image forward to a Receiving Bank to ensure a complete indorsement chain and assist in return routing. For items exchanged under these rules, the electronic indorsement is given the same legal equivalence as a written indorsement. (See Section XIX(E) of the Rules).

The ECCHO Rules define when presentment of the Electronic Image occurs. The Electronic Image is presented to the paying bank when both (i) the presentment notice associated with the Electronic Image and (ii) the Electronic Image are received by, or made available to, the paying bank. The ECCHO Rules establish requirements for the presentment notice and/or the Electronic Image to be presented before certain cut-off times, or else be deemed presented on the next banking day. (See Section XIX(H) of the Rules).

An Electronic Image under the ECCHO Rules is not received for purposes of presentment under the Rules if the file containing the Electronic Image is unprocessable by the receiving Member. In such cases the receiving Member must notify the sending Member of the failure to process the file within one business day of the banking day on which the receiving Member receives the file. For files that are unprocessable and for other situations in which the receiving Member needs another copy of a file, the receiving Member may request the sending Member resend the file within four days of the date of settlement and the sending Member must respond within two business days of the request. (See Section XIX(G) of the Rules). A sending Member needs to determine its own retention period for Electronic Images and files of Electronic Images. For example, a sending Member may voluntarily respond to requests from the receiving Member for copies of Electronic Images outside of this prescribed period, or a sending Member may retain copies of files/Electronic Images for legal or risk reduction reasons.

To provide protections to the Member that receives the Electronic Image from a sending Member, the ECCHO Rules provide a number of warranties that are in addition to the typical check presentment warranties provided under the UCC and Regulation CC. These ECCHO image exchange warranties include, among others, (i) a warranty that the sending Member has complied with the ECCHO Rules with respect to the Electronic Image (for example, that the paper item was eligible for imaging); (ii) a warranty that the Electronic Image accurately reflects the Related Physical Check; (iii) a warranty that the Electronic Image is an Acceptable copy of the Related Physical Check (image quality

warranty); and (iv) a warranty that the Electronic Image is not a duplicate of another Electronic Image. The ECCHO Rules also provide protections to the sending Member in that the receiving Member warrants that it has complied with the ECCHO Rules with respect to the Electronic Image. (See Section XIX(L) and XIX(M) of the Rules).

In the event that a sending Member or receiving Member breaches one of the above warranties with respect to an Electronic Image, the sending Member or receiving Member (as appropriate) is responsible for all damages of the receiving Member or sending Member (as appropriate) caused by such breach. The sending Member's or receiving Member's (as appropriate) liability for a breach of warranty is reduced in proportion to the amount of negligence on the part of the receiving Member or sending Member (as appropriate).

In addition to the above provisions, the ECCHO Rules for exchange of Electronic Images include provisions governing: items eligible for imaging; transmission and acknowledgement of Electronic Image, and Storage and Retrieval of Related Physical Checks and Images.

7. Special Warranty Claims Process

The ECCHO Rules include a special warranty claims process for two warranties made by a sending Member to a receiving Member under the ECCHO Rules and Regulation CC.

First, Section XIX(N) of the ECCHO Rules establishes a process for a receiving Member to make a claim against the sending Member for a breach of the warranty for an unauthorized Remotely Created Check under Regulation CC. (Remotely Created Checks/RCCs are commonly known as "unsigned drafts".) The receiving Member can make this warranty claim by delivering the item (either as a returned check image, a returned substitute check or other returned item) to the sending Member. This delivery of

the warranty claim can be sent through the return check process. There are a number of time periods and other processing requirements that must be satisfied in order for the sending Member to be obligated to make the payment on the RCC warranty claim to the receiving Member. The ECCHO process for this RCC warranty claim does not alter the rights of the parties under the RCC warranty as established by Regulation CC. In other paper check clearinghouses, this type of warranty process is sometimes referred to as a “Rule 8” provision. (See Section XIX(N) of the Rules).

Second, Section XIX(O) of the ECCHO Rules establishes a warranty from the sending Member to the receiving Member that (i) the signature of the drawer customer is not forged or unauthorized, and (ii) the check is not counterfeit. In the event that the drawer customer claims to his/her receiving Member that the check is unauthorized, and therefore the warranty is breached, the receiving Member can make a warranty claim against the sending Member under the ECCHO Rules. This warranty claim can be made by sending the item (either as a returned check image, a returned substitute check or other returned item) to the sending Member through the same process that would have been used for the return of the check. While the warranty claim is processed through the return check process, it is a warranty claim and not the “return” of the check. There are a number of time periods and other processing requirements that must be satisfied in order for the sending Member to be obligated on the warranty claim to the receiving Member.

The Section XIX(O) warranty applies if the first sending Member is the depository bank and the warranty is made by each Member in a forward exchange of the Electronic Image through to the paying bank that is also a Member. While this warranty is generally limited to ECCHO exchanges, the Section XIX(O) warranty also applies to ECCHO Member exchanges involving a depository bank or a paying bank that is a participant in a clearing house (called a “Licensed Entity”) that has licensed the ECCHO Rules for its rules set. Otherwise, this warranty does not apply if there is a non-ECCHO exchange or any paper exchange to the paying bank.

The ECCHO Rules permit a Member to opt-out of this warranty for all Electronic Images that the Member sends and receives under the ECCHO Rules. (See Section XIX(O) of the Rules). In other paper check clearinghouses, this type of drawer authorization warranty rule is sometimes referred to as a “Rule 9” provision.

Both of the warranty claims processes described above only apply on an inter-bank basis between Members. The warranty claims processes do not address the relationship between a Member and its customer. For example, the ECCHO Rules do not address the authority of the sending Member to charge a claim to its customer’s account.

8. Returns Using Electronic Images

The ECCHO Rules also establish a framework for Members to use Electronic Images to return an Electronic Image or a paper check received in the forward check collection process. The ECCHO Rules establish those items that are eligible for return as an Electronic Image Return or as an Electronic Message Return. (These two types of electronic return items are referred to collectively in the ECCHO Rules as an “Electronic/Image Return”). A Member is not required under the ECCHO Rules to accept an Electronic/Image Return, even if the Member has exchanged the item forward as an Electronic Image. (See Section XX(C) of the Rules).

For routing of a return of an Electronic Image or a substitute check created from a forward Electronic Image, the ECCHO rules establish a hierarchy to facilitate the routing of the return to the Depository Bank or other institution acting on behalf of the Depository Bank. The Member returning the Electronic Image (referred to as the “Returning Member”) is required to return the item: (i) to the institution identified as the Depository Bank in the electronic indorsement ; (ii) if no Depository Bank is identified in the electronic indorsement , the requirement is to return the item to the Depository Bank identified on the back of the Electronic Image; (iii) if the Depository Bank is not identified on the back of the Electronic Image, then the requirement is to return to the

institution identified as the Collecting Bank in the oldest applicable electronic indorsement ; (iv) if none of these options are available, the requirement is to return the item to the Member that originally sent the Electronic Image to the Returning Member. In addition, the ECCHO Rules provide that the Returning Member may handle the return based on the information in the electronic indorsement notwithstanding existence of a different indorsement reflected on the back of the Electronic Image (See Section XX(D) of the Rules).

As with Electronic Images on the forward side, Members seeking to return an Electronic/Image Return must establish among themselves in their banking practices agreement the electronic location, time frames and other details for the return of the Electronic/Image Return. The ECCHO Rules also establish additional warranties and indemnities from the returning Member with respect to the Electronic/Image Return, such as a warranty against duplicate return of the item. (See Section XX(J) of the Rules). The ECCHO Rules permit two re-presentments of an item after the first Electronic/Image Return of an item (for a total of three presentments of an item under the Rules). (See Section XX(I) of the Rules).

In addition to the above provisions, the ECCHO Rules for return of an Electronic/Image Return include provisions governing: eligibility for Electronic/Image Return; transmission receipt acknowledgements; and the retention of the original check by the returning Member (if the original check was presented to the returning Member).

9. Adjustments to an Electronic Image Transaction

The ECCHO Rules establish an adjustments framework for Electronic Image exchanges. A detailed matrix of adjustment types is included that outlines requirements such as timing, dollar amount limits, documentation, and settlement of adjustment claims between Members.

Adjustments are permitted for items that were exchanged (forward or return) under the ECCHO Rules or that may arise from an exchange not subject to these rules but the Members have agreed to adjust using the ECCHO Rules. Members may make an adjustment claim directly or through a provider. Members may enter into agreement with a provider to address operational and process details for adjustments.

The Member that receives an adjustment claim under these rules must notify the sending Member of receipt of claim by the end of the next banking day in a format and manner as agreed between the two members or established by a provider. This notice does not constitute an agreement to the claim or make a final settlement. A “with entry” claim settles by close of the banking day following the banking day the claim was received. A “without entry” claim settles either upon agreement of the Members or at the time established by the provider.

The Member may also reject an adjustment under this rule if the adjustment claim: (i) does not comply with this rule, (ii) does not relate to an item handled by the Member, (iii) is a duplicate claim, or (iv) the sending Member has not established factual basis for the claim.

Claims for interest or other compensation are not covered under this rule. Nothing in this rule limits the Member’s ability to bring action in another forum or court to resolve a dispute or claim. (See Section XII and Exhibit II of the Rules).

10. Imperfect Image Items

To support the further exchange of electronic check images ECCHO Members may want to exchange imperfect images. An Imperfect Image Item is defined under these rules as a forward electronic image or electronic image return containing an image which does not conform to industry standards or does not pass image quality standard edits for exchange as an Electronic Image under the ECCHO Rules or applicable

exchange agreement. A sending Member that creates an Imperfect Image Item under this rule must use reasonable efforts to comply with existing industry standards, indorsements, and return requirements. Certain aspects of the ECCHO Rules are varied for these items while other Rules are not applicable.

Imperfect Image Items must be identified by a method established and agreed upon by the Members or other exchange. The sending Member must flag the item even if it did not cause the issue that resulted in the item being an Imperfect Image Item. Flagging such items is not an admission of responsibility.

The Member may create a substitute check from an Imperfect Image Item. However the Member is solely responsible for a loss related to the receipt of such substitute check as the image from which it was created may not meet the requirements of Check 21. The sending Member warrants that it complied with the rules and provides a broad indemnification to protect the receiving Member or its customer from loss due to payment, return or receipt of an Imperfect Image Item. (See Section XV of the Rules).

11. Relationship of ECCHO Rules To The Check 21 Act and Substitute Checks

The ECCHO Rules apply to check images, and therefore do not directly apply to substitute checks, which are paper reproductions of a check image. Substitute checks, and to a certain extent images of substitute checks, are governed by the Check 21 Act and provisions of Regulation CC implementing the Check 21 Act.

The ECCHO Rules do interact with substitute checks and otherwise acknowledge the Check 21 Act in a number of different ways. First, the ECCHO Rules are intended to support the creation and exchange of check images that could potentially be turned into substitute checks by a collecting bank or a paying bank. The Rules accomplish this goal by mandating compliance with various industry standards and limiting the class of eligible paper checks for imaging. (See Section III(A) definition of “eligible item”;

Section V relating to electronic image formats and industry standards; and Sections XIX(C) and XX(C) relating to items eligible for image exchange and return.) In addition, the ECCHO Rules provide a receiving Member with recourse to a sending Member that sends the receiving Member an Electronic Image that the receiving Member subsequently converts into a substitute check, and thereby incurs liability under the Check 21 Act because of a problem with the Electronic Image used to create the substitute check. The ECCHO Rules also contain a provision establishing an expedited recredit process for Members to make a claim for this Check 21 recourse liability, in order to mirror the expedited recredit process in Check 21. (See Sections XIX(Q) (for image exchanges) and Section XX(L) (for similar rules applicable to image returns) of the ECCHO Rules).

12. Settlement of Transactions Exchanged Pursuant To The ECCHO Rules

The ECCHO Rules provide that two Members may settle for items exchanged under the Rules by means of Fedwire transfer or crediting/debiting a due to/due from account. Alternatively, Members may use the settlement functionality of another clearinghouse to which both Members belong. (See Section VI of the Rules).

13. Check Image Exchange Networks and Archives

Many ECCHO Members exchange check images with other ECCHO Members through one or more private-sector electronic networks/archives. The ECCHO Rules support a number of processes for check image exchange, but do not establish the rules for accessing or using private networks/archives. Instead, the networks/archives will typically require the ECCHO Member to also enter into an agreement that governs access to the networks/archives. This network/archive agreement may specify that the ECCHO Rules govern the rights and responsibility of the parties to a check image exchange, and also may detail certain options and features that are allocated to agreement under the ECCHO Rules. For example, the network/archive agreement may address such issues as permissible routing numbers, financial settlement and receipt cut-off times.

In certain cases, two networks may agree to establish a “bridge” or link so that the sending Member can send an electronic check transaction that passes through both networks before being received by the receiving Member. The Members, or the two networks on behalf of the Members, should designate by agreement the governing BPA for these multi-network exchanges. In the event that the Members or the two networks do not designate the applicable BPA, the ECCHO Rules provide that the BPA applicable to the receiving Member will apply to those multi-network exchanges. (See Section XVI of the Rules).

14. Data Security of Check Image Data

ECCHO Members are all depository institutions and are therefore subject to various federal and state data security and privacy laws. In addition, the ECCHO Rules establish certain data security and data breach notification requirements on Members when processing electronic check data. Each Member warrants to other Members that it has established appropriate data security safeguards to protect the electronic check data from unauthorized access during processing and transmission to the receiving Member. In the event there is a breach of data security at the sending Member that results in misuse of the electronic check data, or such misuse is reasonably possible, the sending Member must notify those receiving Members whose data was compromised. The sending Member is also required to pay the costs and expenses of the receiving Member for mailing any notices to its customers that the receiving Member is required under applicable law to send. (See Section IX of the Rules).

15. Role of Third Party Processors

The ECCHO Rules permit a Member to use one or more bank or non-bank processors, of their choice, to provide outsourced services in support of electronic check transactions that the Member exchanges with other Members pursuant to the ECCHO

Rules. However, it is the Member that remains responsible for all of that Member's obligations under the Rules. Any act or omission of the processor in providing these outsourced services shall for purposes of the Rules be deemed to be an act or omission of the Member on whose behalf the processor was acting. (See Sections IV of the Rules). As discussed above in Section 3, an ECCHO Member may authorize its third party processor to enter into exchange agreements on behalf of the ECCHO Member with other ECCHO Members and/or image exchanges/archives. (See Commentary to Section XIX(C) of the Rules).

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For additional information regarding ECCHO, the ECCHO Rules and check image exchange generally, please review the ECCHO website (www.ECCHO.org) or contact a member of the ECCHO staff.