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A periodic newsletter from the Banking Practice Group of Dickinson Mackaman Tyler & Hagen, P.C.

## Remote Deposit Capture: Proceed With Caution

The decision by your bank to supply a merchant with a remote deposit capture scanner signals the beginning of a new customer service relationship, as well as the implementation of a new and useful technology. This new relationship is based largely on your trust in the merchant now in possession of a little piece of your bank—an RDC scanner—in the merchant's backroom or on the merchant's front desk. The merchant is now responsible for paper checks after they are scanned but often lacks the security and expertise of a bank. The merchant may also lack the understanding that scanned paper checks are useless to honest people but exceedingly valuable to someone who wants to exchange them for cash at another bank or use the personal information they contain to make duplicates.

Remote Deposit Capture does not necessarily increase the risk of paper check fraud, but it does change the methods of prevention and puts much of the responsibility for prevention on the merchant. Before inviting a merchant to participate in remote deposit capture, it is important to consider whether the merchant is the right partner for an RDC relationship, to be prepared to educate the merchant as to the responsibilities and risks of RDC, and to execute an agreement that protects the bank.

### **Pick the Merchant Wisely**

Remote Deposit Capture adds convenience for almost any business, but not all businesses have the capability to be effective end-users of RDC. When considering merchants for RDC, engage in a process that allows you to evaluate their general management practices. Where do they keep their check stock? Who has access to checks and petty cash? Is there a lot of employee turnover? Do employees undergo background checks? Is the place of business physically secure? If the business is not responsible about protecting itself from theft and fraud, it is probably not ready to take on responsibility for protecting its customers' information.

### **Fraud Prevention Education**

After the merchant clears the first hurdle, make sure there is a clear understanding of how Remote Deposit Capture functions and the risk of fraud. Work with the merchant to design a plan for handling checks to prevent double-presentment, whether accidental or fraudulent. The plan will likely be based on the how the merchant receives checks for payment and should include procedures for: (1) converting checks into images; (2) securing the paper checks after conversion; (3) maintaining control over retained checks in a secure environment; and (4) removal and destruction of checks after any applicable retention period.

### **The End-User Agreement**

Details of the bank's Remote Deposit Capture relationship with the merchant must be in writing. The vendor who supplied the technology and hardware for RDC implementation may provide a form contract for end-users, but this document likely focuses on protecting the vendor, not the bank. The end-user agreement should set forth the bank's specific expectations, restrictions, and requirements as to the following matters with respect to fraud prevention:

- ◆ Check retention schedules and destruction procedures, including security measures that limit access to checks (possibly dual control with segregation of duties);
- ◆ Place limits on the daily number of deposits or per item value to promote early fraud detection;

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- ◆ Limit RDC to cash items drawn on domestic banks;
- ◆ Impose prohibitions on checks issued by and drawn on the merchant and its affiliates to prevent check kiting schemes;
- ◆ Require education sessions for all employees with access to checks and the RDC scanner;
- ◆ Require bank access to merchant records regarding remote deposits;
- ◆ Required notices to the bank from the merchant regarding changes in location, transaction volume, and financial condition.

### **Beyond Fraud**

Preventing fraud is only part of an effective RDC implementation strategy. The contract should require the merchant to specifically acknowledge the merchant's responsibilities and agree to the following provisions:

- ◆ Any return items will not be of original checks. If an item is dishonored, the client will receive an image of the original check or a substitute check as the charge-back item. Include special instructions or related fees.
- ◆ Image quality requirements: Commentary to Subpart D of Regulation CC specifies elements that must be legible for a substitute check to be considered an accurate representation of the original. Images must meet standards for image quality established by ANSI, the Board of Governors of the Federal Reserve, and other pertinent regulatory agencies.
- ◆ Required scanner: Low-cost scanners may result in poor image quality, so the Bank may prefer to specify a scanner.
- ◆ Only authorized vendors are to provide hardware and software. Specify whether service and maintenance is included in bank fees or paid for separately by the client.
- ◆ The merchant is required to periodically update and replace hardware and software to continue as a RDC client.
- ◆ Transmitting a file does not mean the bank received the file. The bank does not regard a file as received until the bank acknowledges receipt of the file.
- ◆ The merchant agrees to be bound by any clearinghouse agreements, operating circulars, image exchange agreements to which the bank is a party.
- ◆ The bank reserves the right to select the clearing agents through which the bank clears items.
- ◆ Regulation CC does not establish availability requirements for images transmitted to the bank. These must be set forth in the agreement. Consider the following options:
  - Next day availability with case-by-case holds, and establish standards for case-by-case holds and exception holds.
  - Grant the availability by Reg. CC availability schedule and make the determination as to whether items are local or non-local based on the place to which the items are transmitted.
  - Consider all items non-local.
- ◆ The cut-off time for receipt of deposits is based on when the deposit is received by the bank, not when the deposit was transmitted by the merchant. Include the time zone when specifying the cut-off time.
- ◆ The bank's deposit account agreement should be incorporated into the RDC agreement.

In addition to standard contractual provisions, warranties, and indemnification clauses, the bank must take care to shift liability to the merchant for improper compliance with and control of remote deposit capture functions.

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