Remotely created checks: Distinguishing the good from the bad

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There are no hard numbers to quantify that remotely created checks (RCCs) pose greater risks than other payment types. However, there are known instances of RCC fraud, the impact of which can be significant. So the depository banks liable for RCCs may want to keep a vigilant eye on the situation.

What are RCCs?
These are checks that are not created by the paying bank and do not include the account holder's signature. In lieu of an actual signature, the check's signature block typically contains the account holder's printed name or standard language indicating authorization. RCCs have been used for recurring transactions, such as insurance premium payments, for quite some time. This solution offers consumers an alternative to the hassle of manually writing out checks each month. More recently, RCCs have also been used in nonrecurring transactions, such as purchases or bill payments made over the telephone or Internet. Though a useful form of payment, RCCs introduce risk into the retail payments system.

What are the risks?
As stated above, RCCs do not require a signature for authorization. As a result, they are vulnerable to misuse by fraudsters who can, for example, use an RCC to debit a victim's account without receiving proper authorization or delivering the goods or services. The risk of fraudulent RCCs is amplified in one-time purchase scenarios where the merchant is relatively unknown to the customer.

To address the fraud risk of RCCs, in July 2006 the Federal Reserve modified the liability structure for this particular type of check. The liability for unauthorized RCCs shifted from the paying bank to the depositary bank, which must now warrant to the collecting and paying banks that the RCC presented has been properly authorized. The Federal Reserve's amendment provides economic incentive for the depositary bank to perform additional vigilance when accepting RCCs given the warranties they must make. Since the depositary bank maintains the relationship with the bank customer depositing the RCCs, it is in the best position to mitigate the fraud risk. The challenge is that banks cannot readily identify RCCs in an automated fashion through the existing MICR line format. Generally, review of incoming RCCs requires manual intervention.

How pervasive are they?
In light of this identification challenge, the Fed applied a modified definition of RCCs to a sample of check transactions in order to establish a reasonable estimation of the volume of RCCs. As a result, the Federal Reserve's 2007 Check Sample Study concluded that less than 1 percent (0.95) of the checks sampled were RCCs. It is unclear how accurate this result is when considering the regulatory definition, but it is probably fair to say that RCCs are only a very small portion of check volumes overall. Moreover, the analysis did not discern within that estimate the number of illegitimate RCCs. It is the cases of misuse that have prompted some to call for a ban of RCCs altogether. While there is anecdotal information and well-publicized cases (such as the 2008 Wachovia case) highlighting abuses committed using RCCs, there is a lack of concrete data reflecting the portion of RCCs that are fraudulent or returned for other reasons.

Conclusion
RCCs represent a relatively small subset of checks overall. However, applying the Check Sample
Study methodology and results of the Federal Reserve's overall 2007 Payments Study, the number of RCCs in 2006 alone would still have represented approximately 286 million items.

We know that some portion of these RCCs represent fraudulent cases where the payment was never authorized. However, we also know that when it does occur the consequences may be substantial in terms of adverse consumer impact. Therefore, despite the lack of complete data, it is unwise to allow RCCs and the known misuses to fall completely off the radar.

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