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COVID-19 and Banks' Remote Deposit Capture Processes

Financial institutions across the country are adjusting branch operations in response to COVID-19. This often includes temporarily shuttering their lobbies to normal customer interaction. This is expected to drive additional volume, and new users, to the institutions' remote deposit processes. A quick refresher course may be in order for remote deposit capture operations, especially given the expected influx of first-time users within the customer base.

Remote deposit capture ("RDC") permits depository institutions to negotiate for deposit paper items, read "checks," via an electronic image received from commercial and retail accountholders. RDC is now nearly ubiquitous with banks and credit unions, even if not all of the institutions' customers have enrolled. It is remarked that the coronavirus is changing everything, and one of those changes may be, due to the reduction of in-person banking opportunities, the forceable migration by heretofore reluctant customers to the RDC channel. All of this may become even more interesting as "newbie" RDC users deal with the millions of paper checks we are hearing that the government may be soon mailing as part of its coronavirus remediation plans.

Under the present circumstances, we skip over a full review of Regulation CC, 12 C.F.R. § 229, and the principal federal laws implemented thereby, being the Expedited Funds Availability Act of 1987 and the Check Clearing for the 21st Century Act of 2003. Rather, the focus here is on the most likely area of trouble for the RDC product, which is the risk of the double-presentment of a single item. The stereotypical example of this situation is often said to involve an unhappy employee who receives a final paycheck from his or her employer. That payee then may use the RDC process to make deposits at one or more banks via a smartphone photograph of the check, but then later "sell" the paper item to a check-cashing business, which subsequently negotiates that paper item with its own bank for collection. Who wins and who loses in such a

situation?

The Employee/Payee: This wrongdoer likely has violated one or more state and/or federal laws, in addition to having violated the account agreement contracts made with his or her concerned depository institutions.

The Employer/Payor: Its obligation is to pay the debt it created, which means it is to fund – once – the final payroll check it gave to the Employee. However, this Employer may see that its bank account debited several times to pay that single check. Its remedy is against the payor bank that holds its payroll account. Under both the account agreement contract and the Uniform Commercial Code, its obligation is to pay the item, and its bank's obligation is to pay from the account only properly payable items. See, UCC § 4-401 for a starting point.

As for the several banks involved in this RDC mess, Regulation CC's rules governing RDC items will apply and be outcome-determinative. Under 12 C.F.R. § 229.34(g), electronic images and electronic information would be treated as checks under subpart C. Under § 229.34(f), the bank of deposit ("BofD") that presented the actual paper check for deposit (in our example, the check cashing company's BofD) is indemnified by other BofD's of the same item if the original item is returned unpaid because of prior payment via RDC collection. In short, "paper" beats electronic RDC images.

However, Reg. CC's liability scheme will fluctuate, and the paper-checks' BofD's indemnification rights will be lost, IF the paper check was negotiated for deposit over a restrictive endorsement that is inconsistent with the means of deposit. For example, if the paper check had an endorsement on its reverse side which read, "for mobile deposit only," then the check cashing company's bank is out of luck. Also note that the new Reg CC provisions have a 1-year deadline (from the loss event) to bring a claim.

Reg CC indemnification provisions are found in § 229.34(h – k). Of particular interest is that the indemnification risk now in play will include the face amount of the instrument or amount of settlement, accrued interest, costs and reasonable attorney fees. Respecting the resolution of the damages allowed, comparative negligence

offset is allowed for amounts of the “paper” BofD’s negligence or bad faith.

In later posts, we hope to discuss issues relating to the government’s announced plans to mail millions of paper checks as part of its COVID-19 response, and what that means for bankers when confronted with requests from non-customers to cash one of those checks.

For additional information about this topic or any other deposit operations matters, please contact Bill Repasky at (502) 779-8184 or brepasky@fbtlaw.com, or any of the attorneys with Frost Brown Todd’s [Financial Services Industry Team](#).

To provide guidance and support to clients as this global public-health crisis unfolds, Frost Brown Todd has created a [Coronavirus Response Team](#). Our attorneys are on hand to answer your questions and provide guidance on how to proactively prepare for and manage any coronavirus-related threats to your business operations and workforce.

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