

Check Issues Document: Payee Indorsements

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Since the implementation of Check 21 and Remote Deposit Capture (RDC), there have been occasional questions regarding the need and/or requirement for payee indorsements on deposited checks under applicable law and the rules governing image exchange generally.

This document provides some general information and discussion on the topic of payee indorsements. However, nothing in this document is meant to constitute legal or operational advice to a bank or other person. This document does not make a recommendation as to whether or not a bank of first deposit (BOFD) or a paying bank should accept a check for deposit or payment, if the check is lacking a payee indorsement. Banks are encouraged to consider the information in this document with their legal counsels and other appropriate members of their check collection operations.

The following legal, business and operational considerations are offered with respect to decisions concerning the handling of checks without payee indorsements.

Legal Considerations for Both Paying Banks and BOFDs:

- There is nothing in the Check 21 Act, the UCC¹, check image exchange rules or in the RDC implementation guidance that has altered the need for, or the laws/rules governing, payee indorsements on deposited checks as a result of the migration to check image exchange and RDC deposit. In particular, a check that is missing the payee indorsement may be viewed by the paying bank as not properly payable under the UCC. (See UCC Section 4-401(a) and related Commentary; see also UCC Section 3-501(b)(3)). A limited review of case law on this topic has identified court decisions that have reached different conclusions with respect to the status of a check that has a missing indorsement. Some court decisions have viewed a check with a missing indorsement as not properly payable, and in other situations the court decisions have viewed the check as properly payable (for example, if the funds actually reached the named payee). Given the risk of a check being deemed not properly payable, a paying bank may make a decision to return a check missing an indorsement within the paying bank's UCC/Regulation CC return windows (e.g. prior to expiration of the midnight deadline).
- Under UCC 4-205, the BOFD warrants to the paying bank and the drawer customer that the funds were paid to the customer from whom the BOFD received the check.
- The BOFD and other banks transferring checks also warrant to the paying bank that they are entitled to enforce the check. The Commentary to this UCC warranty states that this warranty means there are no missing indorsements on the check. (UCC Section 4-207(a) and 4-208(a); see also Commentary to UCC Section 3-416)

¹ All UCC references in this document are based on the 1990 version of the UCC which has been adopted in all states except New York.

and 3-417). In the event of a breach of this warranty arising from a missing indorsement, a paying bank could seek to bring a claim against the BOFD under these UCC transfer and presentment warranties.

- In light of the protections set forth in UCC 4-205 warranty and the UCC transfer warranties (discussed above), a paying bank could determine, based on its evaluation of legal and business risks for a particular presented check with a missing indorsement, to pay the check even though the check lacks the payee indorsement.

Legal Considerations for BOFD:

- Under UCC 4-205, the depository (BOFD) bank automatically becomes a holder of the check, even if the check does not bear its customer's indorsement, provided the BOFD received the check from its customer that was itself a holder. Under this same UCC section, the BOFD warrants to the paying bank and the drawer customer that the funds were paid to the customer from whom the bank received the check. The BOFD does not have to add the customer's indorsement in order for this warranty to apply as a matter of law.
- BOFDs also should consider the potential risks of UCC warranty claims by paying banks and their drawer customers that may arise some period after the expiration of the UCC midnight deadline for return of checks, in the event there is a missing indorsement on a check. For example, the payee might allege non-receipt of payment, or the drawer customer might allege that the payee indorsement was missing on the check and that the BOFD's customer was not the payee. The BOFD may be liable for a warranty claim to the paying bank in such circumstances, and the BOFD may not be able (for lack of availability or other reason) to charge the check/warranty claim back to the depositing customer.

Additional Operational and Business Considerations:

- BOFDs may want to review their RDC agreements with their customers to ensure that the agreement clearly addresses the depositing customer's obligation to indorse the paper check prior to RDC imaging and transmission to the BOFD. BOFDs should consider including appropriate contractual protections for the BOFD in the event that the depositing customer does not comply with these indorsement requirements.
- BOFDs may want to conduct periodic reviews of its customer's RDC deposits to ensure that the RDC customer is complying with the BOFD's policy on payee/customer indorsements.
- BOFDs should consider the potential increased risk of receiving returns of checks with missing indorsements, and the associated delays in processing such checks. A BOFD may also want to consider the possibility that it may not be able to charge the return back to the depositing customer, if sufficient time has elapsed and the funds have left the account.

- For RDC deposits, some banks recommend or require that their depositing customers also include in the indorsement of the original check such phrases as “for deposit only”, “name of company” and/or “BOFD bank name.” This additional indorsement restriction can help prevent or deter fraud or duplicate deposit. An example of deterrence is the use of the indorsement to prevent the same check from being deposited with two different banks. The presence of a prior bank-specific indorsement should be an indication to the second BOFD to be alert to duplication, theft or fraud. The Federal Financial Institutions Examination Council (“FFIEC”) guidance on RDC and its accompanying IT Examination Handbook encourage the practice of indorsing the physical check in a manner to reduce the opportunity for fraud/duplicate deposit.
- BOFD should also consider the risks that are created for the BOFD when the paying bank returns otherwise valid checks lacking payee indorsements thus delaying ultimate payment decisions. Both paying banks and BOFDs also incur additional cost in the return and representment processes. Examples of sources of additional costs or delays are the practice of representing the check with “a guarantee of indorsement” (a manual process) and obtaining the payee’s indorsement followed by representment.
- A paying bank’s decision to return or pay checks without payee indorsements may depend on a number of business/risk factors, in addition to the UCC warranties discussed above relating to missing indorsements. First, the paying bank decision may depend on the BOFD. For example, a paying bank may be willing to accept a check without a payee indorsement when the BOFD is a bank with which it generally exchanges checks, with which it has a correspondent relationship or with which it has had positive experiences with resolving claims. A paying bank may also make this payment decision based on the payee of the check. For example if the check is payable to the electric company in a moderate dollar amount, rather than to an unknown person, the paying bank may be willing to pay the check even without the payee indorsement since such a check would appear to raise less of a risk of a potential challenge from the drawer customer.