



Check Fraud:

A Practical Guide to Altered,
Forged, and Counterfeit Checks
for Community Bankers

May 2024

This publication is for general information purposes and is not intended to be, and should not be taken as, legal advice. The information in this publication is current as of March 2024.



Introduction

This guide is a resource to help community banks both minimize the incidents of check fraud related to altered, forged, and counterfeit checks and take appropriate steps to recover funds or otherwise minimize loss, when it does occur.

The guide explains how the laws and regulations governing checks assign liability for check fraud to individual banks involved in the issuance, transmittal, and receipt of checks. In addition, it lists various defenses a bank may raise to avoid liability for check fraud.¹ The guide also has three appendices that cover the check fraud landscape, mechanisms for preventing check fraud, and the legal and regulatory regime governing checks.²

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Liability for Altered, Forged, and Counterfeit Checks

Presentment Warranties

The check-clearing process typically involves two or more banks. The customer's bank, also referred to as the "paying bank," holds the customer's account and will pay the check when it is "presented" to the bank for payment. The "bank of first deposit" or "depository bank" is the bank that accepts the check from the payee and credits the payee's account. The bank of first deposit also includes a bank that cashes the check for a party, regardless of whether that party is also an account holder.

For a traditional paper check, the bank of first deposit will send the check back to the customer's bank by transferring the check to other banks that move the check along a chain of banking institutions until it is presented to the paying bank. The process will often include presenting the check to a clearinghouse, such as a Federal Reserve Bank or a regional clearinghouse, that will be able to transfer the check more expeditiously to the paying bank.

With the advent of electronic checks, substitute checks, and similar electronic payments, the clearing process no longer requires the movement of the physical document back to the paying bank. Instead, for these instruments, banks can send electronic images or data that allows the paying bank to debit its customer's account and forward funds to the bank of first deposit.

¹ Unique circumstances may be different, so independent counsel should be engaged as appropriate.

² In recognition of their significant contributions to the preparation of this guide, ICBA acknowledges Ray Natter, Katie Wechsler, and Jim Sivon with Squire Patton Boggs (US) LLP, and ICBA staff members Lance Noggle, Scott Anchin, and Kari Mitchum.



However, with respect to both paper and electronic checks, the bank of first deposit and every bank that is involved in the process makes a presentment warranty to the next bank in the clearing chain and ultimately to the paying bank. As described below, these warranties vary depending on the type of instrument involved, but in all cases the presentment warranties place significant obligations on the bank of first deposit so that these banks have liability for presenting altered checks for payment. Below we describe the presentment warranties applicable to paper checks, electronic checks, and remotely created checks.

A. Paper Checks

Under the Uniform Commercial Code (UCC), every entity that presents a paper check for payment makes a “presentment warranty” that the presenting bank has the authority to make the transfer and receive payment, that the check has not been altered, and that the transferor has no knowledge that the signature of the maker is unauthorized.³

B. Electronic Checks

Electronic checks (or “echecks”) (other than remotely created checks) are electronic documents derived from a paper check. A “substitute check” is an electronic check that contains an image of the front and back of the check. Another form of electronic check transforms a paper check into an electronic message that contains the critical information from the paper check needed for payment, including the routing numbers, amount of the check, and drawer’s account number. Under the UCC and Federal Reserve Board Regulation CC, every entity that presents an echeck for payment makes the same presentment warranty as for paper checks and in addition warrants that the electronic information is correct, and that no person will be asked to make payment on a check that has already been paid.

C. Remotely Created Checks

A “remotely created check” is a payment order created over the phone or internet, without a paper check involved. As such, it does not have the customer’s signature. Typically, a remotely created check will note that the “check was verbally authorized.” Under Regulation CC, a bank that presents a remotely created check warrants that the person on whose account the remotely created check is drawn authorized the issuance of the check in the amount stated on the check and to the payee stated on the check.

D. Effect of Presentment Warranties

Pursuant to the presentment warranties, a paying bank that suffers a loss due to a check alteration, such as a change in the amount or the name of the payee, has a warranty claim against the presenting bank. The presenting bank will then have a claim on the banks further up the collection chain. The liability continues until it reaches the bank of first deposit, which has a claim against the depositor, if he or she can be found. Thus, the

³ In the case of a remotely created payment order, the presenting bank warrants that the order was authorized for the amount specified.



practical effect of the presentment warranty is that the first bank that accepted the check and paid the fraudster will be ultimately liable for alterations in the original check, such as changing the amount of the check. However, the bank of first deposit will not be liable for a forged signature, unless the bank had knowledge that the signature was forged or otherwise unauthorized. The paying bank is responsible for checks with a forged customer signature as well as for imitation checks that were fraudulently produced by desktop software or similar means.

The same is true for remotely created checks, except that the bank of first deposit also warrants that the person on whose account the check was drawn authorized the check. Therefore, unlike the situation for other types of checks, in the case of a remotely created check the bank of first deposit is also liable for a forged drawer signature.

What Happens if the Paying Bank Refuses to Accept the Fraudulent Check?

A paying bank may be able to determine that a check has been altered or is fraudulent upon receipt. For example, the customer's signature may be obviously incorrect, or the alteration of the name of the payee or the amount of the check can be determined by a simple examination. In addition, the bank may have been notified that the check was stolen. If the bank refuses to accept the check due to evidence of fraud, it should immediately return the check to the bank of first deposit by reversing the check clearing process or by notifying the bank of first deposit directly. Complying with the time limits under the UCC and federal regulations will avoid the risk of needless litigation and delays.

Under the UCC, the paying bank has until midnight of the next banking day following the banking day it has received a check to return the check or send a notice of dishonor.⁴ The check is returned using the same check-clearing process, but in reverse. If the paying bank fails to return the check or send the notice of dishonor by the midnight deadline, it is liable for the amount of the check, unless it can raise a permissible defense.⁵

Under the Federal Reserve Board's Regulation CC, the UCC midnight deadline is still applicable, but the regulation also requires that the paying bank must return the check in a manner such that the check would normally be received by the bank of first deposit not later than 2 p.m. (local time of the depository bank) on the second business day following the banking day on which the check was presented to the paying bank.⁶ If the amount

⁴ U.C.C. § 4-302.

⁵ Under the UCC, a bank may establish a cut-off time before the end of the business day, so that checks received after the cut-off time are considered to be received the next banking day. The cut-off time may not be earlier than 2 p.m. U.C.C. § 4-108. Under certain circumstances, such as natural disasters or power outages, the midnight deadline may be extended U.C.C. §4-109.

⁶ 12 C.F.R. 229.31. A paying bank may also use a "qualified returned check" to notify the collecting bank and depository bank that the check is invalid. A qualified return check contains the essential information necessary to identify the invalid check and is encoded with a special MICR line to indicate that the item is a qualified return check.



of the check is \$5,000 or above, the paying bank can provide notice to the depository bank by a telephone call.⁷ Federal regulations specify the details of returning a check or providing notice.⁸ In addition to the notice, the actual check also must be returned.⁹

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If a bank provides provisional credit for a check but later determines that the check is not valid, the bank may charge back the credit or obtain a refund from its customer, even after the midnight deadline. However, if the charge back or notice is delayed beyond a longer than reasonable time after the bank learns that the check is invalid, it will be liable for any loss resulting from the delay.¹²

Who Has Liability for Paying a Fraudulent Check?

A bank's liability for paying on a fraudulent check depends on the type of fraud involved. If the check was altered, the liability falls on the bank of first deposit. The same holds true if there was a forged endorsement. However, if the maker's signature was forged, the paying bank is responsible, as is the case with a counterfeit document, such as a check printed by a fraudster using desktop publishing software. Liability can be reduced or extinguished if the bank can raise one of several available defenses.

This section will describe the various types of fraud and the bank responsible for the loss. It will be followed by material explaining how such liability can be mitigated through one or more recognized defenses.

A. Altered Checks and Forged Checks

Under the UCC, an "altered check" is defined as a change to the terms of a check that is made after the check is issued and that modifies the obligation of a party, such as by changing the payee's name or the amount of the check.¹³ An altered check also includes a

7 Id.

8 12 CFR 229.31(e) and (f) provides that a paying bank returning a check shall clearly indicate on the front of the check that it is a returned check and the reason for return. If the paying bank is returning a substitute check or an electronic returned check, the paying bank shall include this information such that the information would be retained on any subsequent substitute check. If a check is unavailable for return, the paying bank may send in its place a copy of the front and back of the returned check or, if no such copy is available, a written notice of nonpayment containing the specified information. The copy or written notice shall clearly state that it constitutes a notice in lieu of return. A notice in lieu of return is considered a returned check.

9 Under the Federal Reserve Board's Regulation J, a paying bank that receives a check, other than from a Reserve Bank, and that determines not to pay the check, may send the returned check to any Reserve Bank, unless its Administrative Reserve Bank directs it to send the returned check to a specific Reserve Bank. 12 C.F.R. 210.12.

10 U.C.C. § 4-108.

11 U.C.C. §4-109.

12 U.C.C. 4-214.

13 U.C.C. § 3-407. An alteration also includes changing the date on a post-dated check.

check with an invalid endorsement.¹⁴ The following box lists examples of altered checks.

Examples of Check Alteration

- Changing Name of Payee
- Increasing the Amount of the Check
- Modifying Check Date
- Adding a New Payee
- Modification of a Restrictive Endorsement

By contrast, a forgery is a check on which the signature of the drawer (i.e., the account holder) was forged, or where the person signing the check did not have actual, implied, or apparent authority to issue the check.¹⁵ Regulation CC adopts the same definitions for electronic checks and substitute checks.¹⁶ The following box lists examples of forged checks.

Examples of a Forged Check

- Forged maker signature
- Forged signature of a required co-signer
- Creation of a Counterfeit Check through Desktop Publishing Software
- Unauthorized use of an Automated Signature Machine¹⁷
- False Electronic signature

In general, under the UCC,¹⁸ the paying bank may charge the customer's account only for checks that are properly payable. Neither altered checks nor forged checks are properly payable. In the case of an altered check, the paying bank has a warranty claim against the bank that transferred the check to the paying bank,¹⁹ which in turn has a warranty claim against the other banks in the payment stream.²⁰ Ultimately, it is the bank of first deposit that has the liability for the loss due to an alteration. In the case of a forged drawer signature, however, the UCC places the responsibility on the paying bank for identifying the forgery.²¹ Therefore, the bank of first deposit typically bears the loss related to an altered check and for a forged endorsement. The paying bank bears the loss related to a forged drawer signature.

¹⁴ U.C.C. §4-207(2).

¹⁵ U.C.C. § 1-201.

¹⁶ 12 C.F.R. part 229, Appendix E.

¹⁷ However, if the account agreement specifically authorizes the bank to accept a signature produced by such a device, the signature is not considered to be fraudulent.

¹⁸ U.C.C. § 4-401.

¹⁹ U.C.C. § 4-208.

²⁰ U.C.C. § 4-207.

²¹ Except in the unusual situation where the depository bank had knowledge that the signature was forged.

These provisions of the UCC reflect the long-standing rule, originally set forth in the 1762 case *Price v. Neal*, that the paying bank bears the loss when a check it pays is not properly payable because its customer did not authorize the payment. The original theory was that the paying bank is in the best position to determine the validity of its customer's signature. On the other hand, the bank of first deposit is in the best position to detect alterations in the check, since the depository bank should know the depositor, who is the depository bank's customer. Likewise, if the depository bank is cashing a check for a non-account holder, the depository bank is in the best position to know if the non-account holder is trustworthy and has properly identified himself or herself. This rationale made sense when most fund transfers were made with paper checks. The rationale appears less appropriate today when most checks are transmitted and processed electronically, often without human intervention. Nevertheless, the rules continue to assign liability based on the "alteration/forgery" dichotomy even when the banks involved have no real opportunity to examine the check before accepting it for payment.

In 2019, the Federal Reserve Board amended Regulation CC to clarify the burden of proof where there is a dispute as to whether a check has been altered or is a forgery (including instances in which the check was signed by an unauthorized party).²² If there is a dispute about whether the check was altered or had a fraudulent signature, the presumption is that the check was altered. The presumption may be overcome if the preponderance of the evidence is to the contrary. This presumption only applies to substitute checks and electronic checks and is not applicable when a traditional paper check is transferred between the parties. The presumption also does not apply if the original paper check is available for inspection.

B. Cashier's Checks

A cashier's check is issued by a bank and drawn on the bank's own funds. Therefore, the bank is both the drawer and paying bank. The bank that issues the cashier's check that has been altered does not have a claim against the bank of first deposit. This is based on the rationale that the bank issuing the cashier's check should have a record of that check as drawer and should therefore be able to detect any alteration, just as it should be able to detect any forgery of its own name. Thus, the bank issuing a cashier's check that has been altered will be stuck with the loss, unless an applicable defense exists.

C. Substitute Checks

A substitute check is a paper reproduction of an original check that contains an image of the front and back of the check, contains the information on the magnetic character recognition line (MICR line), and meets requirements concerning dimensions and paper stock. A substitute check must accurately represent all the information on the front and back of the original check and bear the legend, "This is a legal copy of your check. You can use it the same way you would use the original check." If these requirements are met,

²² 83 Fed. Reg. 46849 (2019).



a substitute check is legally equivalent to a paper check and subject to the same rules described above, except to the extent different rules are specified in federal law, and in particular Regulation CC.²³

Under Regulation CC, a bank that transfers, presents or returns a substitute check warrants that the substitute check meets all of the requirements to be equivalent to a paper check and that no party to the check will be asked to make payments based on a check that has already been paid.²⁴ These banks also warrant that the substitute check “accurately represents all of the information on the front and back of the original check as of the time the original check was truncated.”²⁵

Regulation CC also provides consumers a process for an expedited refund if a substitute check was incorrectly charged to the account. In order to use these special provisions, the customer needs to show that he or she needs the original paper check or a “sufficient copy” to determine the validity of the claim.²⁶

A claim for breach of a warranty must be made within 30 calendar days after the party has reason to know of the error and the identity of the warranting or indemnifying bank.²⁷ If the claim is late, the warranting bank is excused from liability, but only to the extent of the loss caused by failing to make a timely claim.²⁸

D. Electronic Checks

An electronic check or “echeck” is defined in the Federal Reserve Board’s Regulation CC as electronic image of, and electronic information derived from, a paper check that is sent to a receiving bank pursuant to an agreement between the sender and the receiving bank and that conforms to certain technical standards.²⁹ In general, these regulations treat echecks in a manner similar to substitute checks.

E. Capture of Routing and Payment Information

Another method for receiving payment is to capture the routing number and payment information found on a check and process the payment as an ACH transaction. Technically these are not echecks or substitute checks, but instead an electronic payment subject to the Electronic Funds Availability Act if the account holder is a consumer, as well as the ACH rules promulgated by NACHA. For business accounts, ACH transfer is also subject to UCC Title 4a.

23 12 C.F.R. § 229.51. A bank that transfers, presents, or returns a substitute check warrants that it meets the requirements for legal equivalence, and that no person will be asked to make payment on a check that has already been paid. See, 12 C.F.R. § 229.52.

24 12 C.F.R. §229.51.

25 12 C.F.R. §229.51.

26 12 C.F.R. §229.54 “Sufficient copy” is defined in Section 229.2 (bbb) as “a copy of an original check that accurately represents all of the information on the front and back of the original check as of the time the original check was truncated or is otherwise sufficient to determine whether or not a claim is valid.”

27 12 C.F.R. § 229.56.

28 Id.

29 12 C.F.R. 229.2(ggg).

F. Summary Chart

Type of Check Fraud	Liable Bank
Change in amount of the check	Bank of first deposit
Change in the name of the party to whom the check is written	Bank of first deposit
Change in the date on the check	Bank of first deposit
Invalid endorsement on the check	Bank of first deposit
Forged signature of the person signing the check (the Drawer)	Paying bank
Counterfeit check	Paying bank
Check made out to an “impostor” or fictitious party	No bank liability unless the bank failed to exercise “ordinary care” in handling the item
Altered cashier’s check	Bank that issues the cashier’s check
Counterfeit Check (made through desktop software or similar means)	Paying bank
Substitute check	The bank that creates the substitute check; or, if the substitute check is created by a nonbank, the first bank that transfers or presents the substitute check (the “reconverting” bank).
Substitute Check Warranty Against Duplicative Payments	The bank that creates the substitute check; or, if the substitute check is created by a nonbank, the first bank that transfers or presents the substitute check (the “reconverting” bank).
Substitute Check Special Consumer Protections	The paying bank must complete its investigation of the complaint within 10 business days or provide provisional credit to customer. Paying bank must make final determination within 45 calendar days.
Electronic check	Bank of first deposit unless it can be established by the preponderance of the evidence that the check was forged.

There are numerous defenses that can be raised by a bank faced with a claim for paying on a forged or altered check:

A. Loss is Due to Another's Negligence

A paying or depository bank can defend against liability for paying on an altered or forged check by establishing that another party in the check-clearing process failed to exercise "ordinary care" and that this failure substantially contributed to the fraud.³⁰ This defense can be rebutted by establishing that the paying bank also failed to exercise "ordinary care" and that this negligence contributed to the loss. If there is negligence on the part of both parties, the damages are awarded based on the extent to which the failure of each party to exercise ordinary care contributed to the loss. This is known as the "comparative negligence" standard.

Under the UCC, "ordinary care" means "observance of reasonable commercial standards." Failure to exercise ordinary care is to be determined in the context of all the facts relating to the bank's collection of the check. The Official Comment to the UCC explains that the term "failure to exercise ordinary care" is determined in the context of all the facts relating to the bank's conduct with respect to the bank's collection of the check, including the names on the account, amount of check, circumstances of account opening, and actions of the account holder.³¹

However, "reasonable commercial standards" do not require a bank to physically examine the check if consistent with general banking practices in the area. Thus, a bank is not negligent for using automated processes for clearing checks rather than individually examining the checks for fraud, assuming that is the standard practice.

Court determinations of negligence that may mitigate the extent of the damages vary from case to case, and no doubt reflect the court's subjective view as to the relative merits of the parties claims and personal hardships that may result from a finding of negligence that will offset a bank's liability. It is far more likely for a court to find negligence when the customer is a large corporation rather than when the customer is struggling to support a family. And a bank may wish to avoid the negative publicity resulting from dispute with consumers who have suffered a financial loss. Nevertheless, below we provide examples of conduct that has been found to be negligent and, therefore, reduce a bank's liability.

³⁰ U.C.C. § 3-406. The bank must be a "holder in due course," meaning that the bank must have paid the check or took the check for value or collection and was acting in good faith.

³¹ Official Comment to U.C.C. § 3-405.

Examples of Negligence:

Failure to Safeguard Checks: Bank is determined to be not responsible for paying a forged check because the customer kept the blank checks in an unlocked cabinet in a busy area. Similarly, the UCC comments state that a paying bank may raise customer negligence for an unauthorized check when the customer failed to safeguard a signature stamp used for signing checks.³²

Transmitting the Check to the Wrong Address: A company is advised of a change of address but fails to correct its records and sends the check to the old address, where it was stolen and fraudulently endorsed. Bank may argue that the company's negligence contributed to the loss.³³

Leaving Excessive Space on Check: The drawer leaves space on the check so that alteration of the name of the payee or amount is easily accomplished.

Failure to Provide Internal Controls: Failure to screen or have appropriate internal controls over employees with check-writing authority.

Negligent Hiring: Liability for hiring an employee expected to come into contact with the public without making a reasonable inquiry to ascertain fitness and reliability. Negligent hiring can be asserted when a bank employee participates in a fraud or fails to competently perform duties that would have prevented the fraud or reduced damages.

Failure to Question Unusual Payroll Checks: A bank was found to be 90 percent responsible for failing to question insurance checks were being claimed by an employee to be salary payments.³³

B. Customer Fails to Promptly Review Statements

Under the UCC, customers must exercise "reasonable promptness" in examining the monthly statement of checks drawn on their account to determine if any item was unauthorized or altered.³³ The customer must promptly notify the bank of any such discrepancy. The statute provides that a customer who does not report the fraud within one year after the statement is made available is precluded from recovery. However, the one-year period may be shortened by agreement, typically the deposit agreement.

A special rule applies in the case of a continuing fraud, where a series of bad checks are presented for payment by the same bad actor. In that situation, if the customer does not notify the bank of the first fraudulent check within 30 days after receiving the bank statement, there is no bank liability for paying on additional checks received from the

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³³ U.C.C. 4-406.

same fraudster after the 30-day period, unless the customer establishes that the bank was negligent when it paid the additional checks.³⁴ If negligence is found, the loss is divided between the bank and the customer based on comparative negligence principles.

C. Paying Bank Failed to Timely Notify Depository Bank

The paying bank is required to provide notice of an alteration within 30 days after it has reason to know that the check has been altered.³⁵ If notice is not given within the 30-day period, the warrantor is discharged to the extent of any loss caused by the delay in giving notice. A bank might have “reason to know” that a check has been altered if the alteration has been reported by its customer. Courts have also found that a bank has “reason to know” if the check has obvious irregularities, indications of alteration, or is endorsed to an employee rather than to a corporate deposit account.³⁶

D. Endorsement Fraud Was Committed by a Trusted Employee

Under the UCC, if an employer entrusts an employee with responsibility for processing a check, and the employee fraudulently endorses the check by signing the name of the employer on the back of the check, a bank honoring the check as endorsed is not liable for an action based on a forged endorsement.³⁷ The same rule applies in connection with a check issued by the employer to a third party, and the trusted employee forges an endorsement by signing the name of the original payee.

E. Comparative Negligence Reduces Liability

Section 3-406 of the UCC establishes a comparative negligence scheme allocating loss between the bank and the customer if both parties failed to exercise ordinary care that contributed to a fraudulent instrument.

F. Civil Action Brought After Statute of Limitations Expired

Under the UCC, a civil action which is based on the payment of a check to a person not entitled to receive payment is subject to a three-year statute of limitations.³⁸ The three-year period begins to run on the date the cause of action “accrues.” The vast majority of the case law holds that, in the absence of fraudulent concealment, a cause of action accrues when the bad check was deposited or cashed.³⁹ However, some courts have held that the cause of action accrues when the plaintiff “knows or reasonably should know” that a wrong has been committed, which could have the effect of extending the statute of limitations beyond three years.⁴⁰

³⁴ Id.

³⁵ U.C.C. § 4-207.

³⁶ See, [Sun'n Sand, Inc. v. United California Bank](#), 582 P.2d 920 (Ca. 1978)

³⁷ U.C.C. § 3-405.

³⁸ U.C.C. §3-420.

³⁹ See, e.g., [Hawkins v. Nalick](#), 363 Ill. Dec. 767, 975 N.E.2d 793, 798 (Ill.Ct.App.2012) (reviewing cases and concluding that an “overwhelming majority” of jurisdictions do not apply the discovery rule).

⁴⁰ [Newell v. Newell](#), 942 N.E.2d 776, 782 (2011); [Borchers v. Vanguard Grp. Inc.](#), No. 2:08-CV-02138-REJ, 2011 WL 2690424 (D. Ariz. July 11, 2011).

G. Check Was Made Out to Fictitious Payee

If a customer is tricked into writing a check payable to an impostor or fictitious payee, there is no bank liability unless the customer can prove that the bank failed to exercise “ordinary care” when paying the check.⁴¹

H. Common Law Claim Preempted by UCC or Federal Regulations

The UCC provides that common law principles regarding such matters as capacity to contract, fraud, misrepresentation, mistake, agency, and similar matters may supplement the UCC, unless the common law is displaced by a particular provision in the UCC.⁴² However, most courts have ruled that in order to foster the objectives of legal certainty and uniformity, the UCC should be considered to provide the remedy for disputes involving negotiable instruments and bank deposits.⁴³ Accordingly, the majority of courts have refused to recognize common law as applicable in resolving check fraud disputes. However, this is not the rule in all states. For example, in Vermont a court permitted a common law claim against a bank for “unjust enrichment” despite the fact that the claim was barred under the UCC’s three-year statute of limitation.⁴⁴

I. Summary of Defenses Issues

The following table summarizes the relevant defenses available when check fraud results in a loss, including the time periods to provide notice or return an item.

Allegation	Defense	Comment
Forged drawer signature	Drawer was negligent by allowing access to blank checks.	Comparative negligence rules apply. Customer negligence can reduce the amount of damages, but unlikely to eliminate bank liability.
Forged drawer signature	Customer failed to promptly notify the paying bank.	The UCC provides a one-year requirement after receiving monthly statement. But this can be shortened by agreement.
Forged drawer signature	Action was brought after the three-year statute of limitations.	Time limit begins when the customer knew or should have known of the fraud.

⁴¹ U.C.C. 3-404.

⁴² U.C.C. 1-103(b).

⁴³ See, e.g., *AmSouth Bank v. Tice*, 923 So. 2d 1060, 1066 (Ala. 2005) “[C]ommon-law claims are displaced or preempted if allowing the common-law claims would ‘create rights, duties, and liabilities inconsistent’ with those set forth in [the UCC statutes.]”.

⁴⁴ *Crossman v. RBS Citizens, N.A.*, 2023 Vt. Super. LEXIS 84 (2023).

Allegation	Defense	Comment
Forged Endorsement	Negligence in the handling of the check allowing fraudster to gain access.	Comparative negligence rule applies.
Forged Endorsement	Person who forged the endorsement was a “trusted” employee of the payee.	Comparative negligence rule applies.
Forged Endorsement	Claim barred by relevant statute of limitations.	Check individual state law to see if three-year rule applies.
Name of Payee Changed	Maker negligence, customer failed to promptly notify bank, statute of limitations expired.	Check individual state law to see if UCC three-year limitation has been changed.
Amount altered	Maker negligence, customer failed to promptly notify bank, statute of limitations expired.	Check individual state law to see if UCC three-year limitation has been changed.
Check made to a fictitious payee or impostor	No bank liability unless bank failed to exercise “ordinary care.”	Banks should be suspicious of potential impostor ruses.
Common Law claim against bank	Common law preempted by UCC and federal regulations.	Confirm that this rule applies in your state.
Signature on Substitute Check is forged	Under regulation CC, the presumption is that the check was altered, and not a forged maker’s signature.	Presumption may be overcome by a “preponderance of the evidence.”

Although the use of checks is decreasing as a payment method,⁴⁵ check fraud is growing at an exponential rate. In 2022, there were 680,000 reports of check fraud, nearly double the reported incidents in 2021.⁴⁶ Worse, the amount of losses due to check fraud is twice the amount it was in 2018⁴⁷ and is estimated to account for \$24 billion in fraud losses in 2023.⁴⁸ In February 2023, the Financial Crimes Enforcement Network (FinCEN) issued a special alert noting the dramatic increase in check fraud and warned banks to be especially vigilant in recognizing and reporting mail related check fraud.⁴⁹

Further, resolving responsibility for reimbursing the fraud victim can be legally complex, and community banks do not typically have in-house litigation attorneys who can address the legal liability issues in court. This makes it more expensive for a community bank to recover a payment that was made due to check fraud. Thus, according to the Federal Reserve Bank of Richmond, smaller banks are bearing the brunt of check fraud when trying to get repaid from larger institutions.⁵⁰

Common check fraud scenarios include:

A. Postal Theft

As a result of the economic disturbances caused by the pandemic and the relief programs passed by Congress, many checks were mailed to the American public in an effort to ameliorate the loss of income due to business closures. Realizing that a great number of checks were in the mail system, fraudsters began to aggressively steal mail that appeared to contain COVID-related checks.⁵¹

Post-pandemic, this trend has continued, and the number of checks stolen from the U.S. mail has dramatically increased. Fraudsters target mail containing personal checks, business checks, tax refunds, and government assistance payments.⁵² According to the U.S. Postal Service Inspector General, from March 2020 through February 2021, there were 299,020 mail theft complaints, which was an increase of 184,564 (161 percent) complaints compared to the same period in the previous year.⁵³

45 According to the Federal Reserve Bank of Boston, the number of checks processed through the Federal Reserve declined from 19 billion items in 1993 to only 3.4 billion in 2022. <https://www.bostonfed.org/news-and-events/news/2023/08/check-fraud-rampant-mike-timoney-column-fraud-awareness-key-to-slowing-surge.aspx>.

46 New York Times, "Check Fraud is on the Rise," March 10, 2023.

47 Id.

48 Id.

49 <https://www.fincen.gov/sites/default/files/shared/FinCEN%20Alert%20Mail%20Theft-Related%20Check%20Fraud%20FINAL%20508.pdf> (hereinafter "FinCEN Alert.")

50 https://www.richmondfed.org/banking/banker_resources/regulatory_perspectives/news_flash/2023/202303_check_fraud

51 FinCEN Advisory on Financial Crimes Targeting COVID-19 Economic Impact Payments (Feb. 24, 2021)

<https://www.fincen.gov/sites/default/files/advisory/2021-02-25/Advisory%20EIP%20FINAL%20508.pdf>

52 FinCEN Alert. <https://www.fincen.gov/sites/default/files/shared/FinCEN%20Alert%20Mail%20Theft-Related%20Check%20Fraud%20FINAL%20508.pdf>.

53 Office of the Inspector General, U.S. Postal Service, "Audit Report No. 22-178-R23," (September 38, 2023).

B. Check Washing

Often, after a check is stolen, it is altered through a process known as “check washing” to change the name of the person or entity to whom the check is written (i.e., the “payee”) and the amount of the check. This may be accomplished by using chemicals to remove the ink on a check, permitting the fraudster to change the dollar amount, the payee, or both.

C. Alterations

An alteration is an unauthorized change in a check that modifies or changes the amount of the check or the payee. This includes the unauthorized addition of words or numbers to a completed check, as well as any additions or changes to an incomplete check. Thus, an alteration occurs when a fraudster takes a legitimate check and changes important information, such as the amount or payee. The box below lists some examples of unlawful alterations.

Examples of an Unlawful Alteration

- Adding words to the check to change the payment amount.
- Erasing the name of the payee and inserting a different name.
- Changing the date of a check.
- Forging the signature of an endorser.

D. Check Kiting

Check kiting is the practice of depositing a check that is not valid when deposited, then withdrawing the funds before the bank is advised that the check is not going to be paid. This scheme relies on the fact that there can be a lapse between the date on which a check is credited to the depositor’s account and the date the bank receives final payment. This time lapse is referred to as “float.” This form of check fraud is exacerbated by federal regulations that require a bank to make funds available to a depositor within prescribed time frames.⁵⁴ Fraudsters may therefore be able to obtain payment for deposited checks before the bank receives notification that the check is invalid.

E. Impostor

Impostor fraud involves the assumption of someone else’s identity by a fraudster. For example, the fraudster may obtain the name, address, bank account number, Social Security number, and other identifying information of a legitimate customer, and use that information to obtain funds from a customer’s account or to open a new account using the stolen information. An impostor also may falsely claim to be the payee of a check and obtain the funds using that false identity.

54 Federal Reserve Board Regulation CC, Subpart A, 12 C.F.R. §§ 229.1 et. seq.



F. Facsimile Checks Created by Desktop Publishing Program

The use of sophisticated desktop publishing programs allows a fraudster to create facsimile checks that are almost impossible to detect by machine readers or personal examination. This technology can be used to make new checks that are identical to legitimately issued items, except with a different payee and amount. Technically these checks are not considered to be “altered” but rather “counterfeit.”

G. Counterfeit Cashier’s Checks

A cashier’s check is a check issued by a bank that is drawn on the same bank. In other words, the bank is both the drawer and the payor on the check. For example, a customer may transfer \$1,000 in cash to a bank. The bank then will issue a check to the customer’s payee for \$1,000 to be drawn on the bank’s own funds. As a result, a cashier’s check is said to be guaranteed by the issuing bank.

Fraudsters utilize the perceived safety of a cashier’s check, and the fact that funds deposited through a cashier’s check must be made available by the next business day, to engage in fraud. For example, a fraudster may use a desktop publishing program to print a counterfeit cashier’s check and use that check to transfer funds to the victim. These counterfeit checks can be used for purchasing expensive items, such as an automobile or luxury items sold over the internet. The victim deposits the cashier’s check expecting that it will be cleared within 24 hours. After the time period has expired, the victim proceeds with the sale, thinking that his or her bank has received the funds, but learns days later that the check was counterfeit. Alternatively, the fraudster will transmit a counterfeit cashier’s check for an amount larger than the sales price and ask the seller to return the overage. Of course, since the check was counterfeit, there was no overage, and the fraudster absconds with the payment.

H. Double Deposit Scams

Fraudsters may transform a traditional paper check into an electronic file that will be converted by the depository bank into a substitute check. Because it was received electronically, the substitute check will be cleared quickly. The criminal can then deposit the traditional paper check into a different depository institution or endorse it to a third party, such as a check-cashing company. The paying bank may not recognize that the check had already been paid. If it is detected, it may be too late to prevent the criminal from receiving two payments.

Appendix 2: Mechanisms for Preventing Check Fraud

There are various actions a bank can take to prevent or limit liability related to check fraud. This appendix lists such actions.⁵⁵

A. Require Faster Customer Notice of Invalid Check

Under the UCC, a customer has up to one year to notify the drawee bank that a fraudulent or otherwise invalid check has been paid. However, the UCC permits this time frame to be modified through an agreement with the customer, including through a provision in the account opening agreement. For example, a bank may use the account agreement to require notification in 15 to 30 days following receipt of the monthly statement, and the customer may agree to be liable for fraudulent checks not reported within this time limit. It is important to check the UCC and consumer protection laws in the state in which the bank is located to see if minimum time requirements are mandated and have been imposed by state laws.

The following box provides sample provisions that could be included in an account agreement to limit the time period for the notification of an error.

Examples of Account Agreement Modifying One-Year Notice

“You have a responsibility to review your account statement in a timely manner and to notify us promptly of any errors. Within thirty (30) days after we send or make available to you your account statement and accompanying items, you must notify us in writing of any errors, discrepancies, or unauthorized transactions. If you fail to do so, we will not be liable for debits or charges to your account resulting from such errors, discrepancies or lack of authorization, or for losses resulting from subsequent related occurrences.”

“You have a responsibility to review your account statement in a timely manner and to notify us promptly of any errors. Within sixty (60) days after your statement is postmarked or made available to you, or account transaction history is made available to you through our online banking services, you must notify us in writing of any errors, discrepancies or irregularities, including unauthorized signature, alterations, improper charges, unauthorized transfers or withdrawal of funds, nonreceipt of an expected statement, or that any deposit was not properly credited to your account. We will not be responsible for any loss suffered by you if you do not notify us in writing within these stated time periods.”

⁵⁵ This publication is for general information purposes and is not intended to be, and should not be taken as, legal advice. The information in this publication is current as of March 2024.



B. Limit Consequential Damages and Require Customer Cooperation

Although the UCC limits liability for the failure of the bank to exercise ordinary care to the amount of the check, the limit does not apply when the plaintiff alleges bad faith. The account agreement can attempt to avoid claims for other damages by specifying that the bank will not be liable for indirect, special, or consequential damages, and that the bank's liability for paying on an altered or forged item is limited to the face amount of the item. The account agreement can also require the customer to cooperate in any investigation, including filing a report with law enforcement.

C. Include a Specific Statement in the Account Agreement that Provisional Credits May be Reversed

To avoid litigation risk, the account agreement should explicitly state that while provisional credit may be given for deposited checks, that credit may be reversed if the check is returned unpaid.

Examples of Account Agreement Language Explaining Provisional Credit

When Does a Check Clear? This process begins when you deposit a check to your account and is not completed until the bank on which the check is drawn either honors or returns it to the bank unpaid. Checks may be returned because of insufficient funds, missing signatures, stop payment orders, etc.

Please note that a check you deposit may be returned unpaid after we have made the funds available to you. If this happens, the amount of the returned check will be deducted from your account balance.

D. Recommend or Require the Use of “Positive Pay” or Similar Program

Positive Pay is an automated fraud detection tool that matches the account number, check number, and the amount of the check presented for payment with a list of checks previously submitted by the customer, typically a business. This permits the paying bank to electronically match the incoming check with the list of outstanding checks provided by the customer. The list is provided in an electronic file so that the matching can occur automatically. An incoming check that is not identified as outstanding will not be paid unless affirmed by the customer as valid. While this system affords some protection to the bank and its customer, it does not protect against checks that have the correct number and amount, but with an altered payee or forged endorsement.

E. Recommend the Use of FedPayments Reporter Service

The FedPayments Reporter Service provides various tools to prevent fraud with respect to payments made through a Federal Reserve Bank. The Corporate Payor Reports allows corporate customers to review check details the morning of presentment using secured email. The customer is sent a picture of the incoming check to permit examination for alterations, thus allowing the customer to notify the payor bank of the fraud on the same day as presentment. The Check Advanced Notice Return Report provides the depository



bank with advanced notice of items being returned through a Federal Reserve Bank. And the Check Advanced Notice Report provides the paying institution with advanced notice of items that will be delivered through a Federal Reserve Bank and provides early awareness of large checks to help mitigate against fraud.

F. Train Employees to Identify Check Fraud

Bank employees that handle checks or payments should be trained in identifying red flags indicating potential check fraud. The OCC notes that bank tellers play a crucial role in identifying fraud, and that financial institutions must emphasize to all tellers the importance of being alert to check fraud and recognizing red flags.⁵⁶

G. Use Screening and Internal Controls to Prevent Bank Insider Fraud

Bank employees should be carefully screened with appropriate background checks. According to a recent OCC bulletin, a bank's risk management system should include policies, processes, personnel, and control systems to effectively identify, measure, monitor, and control fraud risk consistent with the bank's size, complexity, and risk profile. Further, a bank's risk management system and system of internal controls should be designed to prevent and detect fraud, and appropriately respond to fraud, suspected fraud, or allegations of fraud. See, OCC Operational Risk: Fraud Risk Management Principles (2019)⁵⁷ for further details.

H. Educate Customers on Ways to Prevent Fraud

Bank liability for check fraud can be reduced by educating customers on methods that make it more difficult to commit the fraud. Further, to the extent that a customer fails to follow the bank's recommendations, it may make it easier to allege that the customer was negligent and, therefore, the bank's liability for damages should be reduced.

Below are examples of the type of information that can be included in a customer education program:

1. Promptly review bank statements and verify all checks drawn on the account.
2. Validate that endorsements are appropriate, especially those made to cash or unknown third parties.
3. Determine the reason for any unexplained debits.
4. Institute internal controls so that the personnel authorized to issue checks is different from the personnel reviewing bank statements.
5. Do not leave any blank spaces on the payee and amount lines. Use a pen with blue or black non-erasable gel ink that is more difficult to erase.
6. Make sure the amount written in words and numbers match.
7. Do not give out account information to anyone who is not trustworthy.

⁵⁶ <https://www.occ.gov/publications-and-resources/publications/banker-education/files/pub-check-fraud.pdf>.

⁵⁷ <https://occ.treas.gov/news-issuances/bulletins/2019/bulletin-2019-37.html>.

8. Safeguard unused checks. Check to make sure that there aren't missing or unused checks.
9. Properly dispose of unused checks and old checks that are no longer needed, so that the information on the checks cannot be used by others.
10. Conduct appropriate vetting of employees that will have authority to write checks or that will process checks that are incoming.
11. Secure signature stamps and automatic check signing equipment.
12. Consider alternatives to checks, including electronic bill paying programs, such as Zelle, and credit card digital payments.
13. When mailing a check, bring it to the post office rather than dropping it in a mailbox.
14. Do not use envelopes that identify the contents as a check or that are typically used for bill paying. Use security envelopes that are opaque to hide the contents of the envelope.

I. Artificial Intelligence to Monitor Transactions, Verify Check Stock, and Authenticate Signatures

Consider using third-party vendors that can implement a transaction analysis or transaction monitoring program that uses artificial intelligence to identify unusual or suspicious activity, such as duplicate check numbers and suspicious account activity. These products can also analyze images of presented checks to determine if the check is written on paper that is different than the check stock used by the bank. These products can identify differences in paper quality and characteristics that cannot be detected by the human eye. Another new technology can automatically compare digitized signatures to the signatures on file with the bank and can also monitor checks made out to two or more payees to ensure that all required signatures are present.

J. Issue Checks with Anti-Fraud Protection

Some check stocks can include anti-fraud features, including special paper that is not generally available, micro-printing of security codes, embedded security fibers, foil holograms that cannot be duplicated, and special chemicals that highlight erasures or attempts to “wash” checks. Banks may want to offer checks with these or similar protection to customers to reduce check fraud losses.

K. Substitute Checks

Substitute checks create the potential for fraud because the original paper check is not voided when a substitute check is created. Therefore, there are two payment instruments in existence, and a fraudster can deposit both instruments in different banks, thereby double debiting the drawer's account.

This fraud can be reduced by requiring the customer to indicate on the face or back of the check that it has been scanned or electronically processed, so that anyone obtaining possession of the original paper check would be on notice that a substitute check has also been created. The bank should also consider requiring that the customer destroy the original check within some reasonable period to mitigate the potential that it will be deposited, either intentionally by a fraudster or by accident.



Another concern is that a bank customer may deposit a substitute check that was processed by a bank. In this situation, the depository bank will be treated as the reconverting bank, even though it did not create the substitute check. As such, it will be exposed to liability if the customer's substitute check contains fraudulent terms. A bank can mitigate this risk by requiring customers to obtain advanced approval before submitting substitute checks that have not been created by a financial institution.

Appendix 3: Legal and Regulatory Regime Governing Checks

Checks are governed by a complex array of laws, regulations, and private agreements. This appendix provides an overview of this regime.

A. A Note on Terminology

The laws and regulations applicable to checks, especially, the Uniform Commercial Code (the “UCC”) and the Federal Reserve Board’s regulation governing substitute checks, Regulation CC, contain key definitions to describe the parties in the check-clearing process. However, while many of the terms used are identical, there are some variations. To provide common terms for this and the remaining sections of the guide, the following definitions will be used:

- **Collecting bank or Intermediary bank** refers to a bank to which a check is transferred for collection, but is not the depository bank or the payor bank.
- **Customer** means a person having an account with a bank.
- **Drawer or Maker** is the person directing payment from their account; the customer who signs the check and is ordering the payment.
- **Depository bank or Bank of First Deposit** is the first bank to take the check.
- **Electronically created item or Electronic Payment Order** means an electronic image that has all the attributes of an electronic check but was created electronically and not derived from a paper check.
- **Payee** is a person or entity to whom a check is written.
- **Paying Bank** is the bank that is directed to pay on the check. The Paying Bank is the same as the Drawee Bank or, as used in this document, the “Customer’s Bank.”
- **Substitute Check** means a paper reproduction of an original check that contains an image of the front and back of the check, contains the information on the magnetic character recognition line (MICR line), contains a required legend⁵⁸, and meets technical requirements such as the dimensions of the document and type of paper stock.

Truncate means to remove an original paper check from the check-collection process and send instead a substitute check or, with the agreement of the parties, an electronic message containing the information necessary to pay the check. Truncation may be accomplished by individual banks or through an intermediary, including a Federal Reserve Bank.

⁵⁸ The substitute check is required to have the following legend: “This is a LEGAL COPY of your check. You can use it the same way you would use the original check.”



B. Uniform Commercial Code

The UCC is a model state law developed by the Uniform Law Commission⁵⁹ and the American Law Institute. The Uniform Law Commission is a nonprofit association composed of state commissions on uniform laws from each state, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. The American Law Institute is a private organization that has the mission of promoting the clarification and simplification of the law, securing the better administration of justice, and encouraging and carrying on scholarly legal work.⁶⁰

The UCC addresses commercial transactions, including transactions involving negotiable instruments and bank deposits. The UCC has been adopted, with some modifications, in all 50 states, the District of Columbia, Puerto Rico, and other U.S. territories.⁶¹ Because the UCC establishes essentially uniform rules throughout the United States, it facilitates payment transactions that cross state lines, providing assurance that consistent rules will be applied regarding payment requirements and liabilities.

C. Check 21

The Check Clearing for the 21st Century Act (Check 21) was enacted by Congress in 2003 and became effective the following year.⁶² This federal law permits the use of digital technology to effect payment transactions using electronic communications. The law does not mandate the use of this technology, but the efficiency of electronic transmission of payment information has led to widespread acceptance. As a result, since the passage of the Check 21 legislation in 2003, the use of paper checks for clearing payments has declined precipitously.⁶³

Under Check 21 and Federal Reserve Board rules, a bank can create an electronic image of both sides of the check and transmit that image in lieu of the paper check. When printed on paper, these “substitute checks” are the legal equivalent of a traditional paper check for all purposes so long as the paper image contains all the information from the original check and states “This a legal copy of your check. You can use it the same way you would use the original check.”

It is important to differentiate a substitute check from an “electronic check” or “echeck.” An “electronic check” is not the same as a substitute check. Instead, it is an electronic record of the payment information and routing numbers contained on the check, not a reproduction of the actual check. Therefore, electronic checks do not have pictures of the signature of the drawer or endorser. The rules governing echecks differ from those covering substitute checks.⁶⁴

⁵⁹ Also known as the National Conference of Commissioners on Uniform State Laws.

⁶⁰ <https://www.ali.org/about-ali/>.

⁶¹ For links to each state's UCC, see https://en.wikipedia.org/wiki/Uniform_Commercial_Code_adoption.

⁶² Check Clearing for the 21st Century Act of 2003 (P.L. 108-100) (2003).

⁶³ According to the Federal Reserve, today almost all checks processed by the Reserve Banks use electronic check collection services rather than paper. https://www.federalreserve.gov/paymentsystems/check_about.htm.

⁶⁴ For example, if the echeck payment is from a consumer's account, the transaction is subject to the Electronic Funds Availability Act and the Consumer Financial Protection Bureau's Regulation E.



While Check 21 makes check processing more efficient and eliminates the costs of physically moving paper checks, it also makes it easier for criminals to commit fraud, such as by making it harder to detect alterations and forgery. Further, when the paper check is destroyed, the evidence contained on the check, such as fingerprints, is also destroyed.

D. Regulation CC

The Federal Reserve Board's Regulation CC⁶⁵ governs the time deposited funds must be made available to customers under the Expedited Funds Availability Act, and detailed instructions and requirements for substitute checks under the Check 21 Act.⁶⁶

E. Regulation J

The Federal Reserve Board's Regulation J⁶⁷ contains the rules for governing the payment services of a Federal Reserve Bank, including the terms for submitting a check or other item for collection and the return of unpaid items. Regulation J is supplemented by Operating Circulars and other guidance. Both Regulation J and the relevant Operating Circular have been revised to take into account Check 21 and the development of electronically created payment instruments.

F. Electronic Check Clearing House Association (ECCHO) Rules

The Electronic Check Clearing House Association (ECCHO) provides electronic check clearing services for member institutions. ECCHO rules provide that a depository bank warrants to the payor bank that (i) the signature of the purported drawer is not forged or otherwise unauthorized, and (ii) the related physical check is not counterfeit. This requirement only applies to electronic checks exchanged under ECCHO rules by ECCHO members who have agreed to use ECCHO rules and not opted out of ECCHO rules regarding warranties and counterfeit checks.⁶⁸ As a practical matter, this warranty shifts the loss from the payor bank to the depository bank when there are sufficient funds in the depositor's account to pay the item. The loss remains with the payor bank if there are insufficient funds in the depositor's account to cover the fraudulent item once the claim is received by the depository.

⁶⁵ 12 C.F.R. part 229.

⁶⁶ 12 U.S.C. §§ 5001-5018.

⁶⁷ 12 U.S.C. part 210.

⁶⁸ ECCHO Rule 9 provides that a depository bank warrants to the paying bank that (i) the signature of the purported drawer is not forged or otherwise unauthorized, and/or (ii) the related physical check is not counterfeit. Rule 9 is only available for electronic checks exchanged under ECCHO Rules by ECCHO members who have agreed to use the Rules and not opted out of Rule 9.
