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## ASK KENNEDY

### November 13, 2024

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#### **Special Guest: Rick Clayburgh | President and CEO, North Dakota Bankers Association**

Please welcome this month's guest, Rick Clayburgh! Rick will be talking about the effects of the recent presidential election and what NDBA sees for the future of banking.

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#### **Member Questions**

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**Question 1:** Question for you for our Fraud Peer Group regarding your take on Presentment Warranty Violations, UCC 4-208/ 3-417.

We've been encountering issues resolving presentment warranty claims with our larger bank cousins. Who are, not surprisingly, receiving the lion share of these claims.

Specifically, there is disagreement regarding interpretation of what the statute means as an "altered" draft.

The large banks have been refusing to pay claims when original checks are chemically washed or mechanically scratched, removing all the ink from the paper.

The original paper is then rewritten with a new payee and/or new amount. The signature is traced in again.

My opinion, is that check has been altered. The large banks believe that check has been forged – which gets them out of the presentment warranty.

I would litigate the spirit of the statute puts liability on the party best capable of the detecting the problem.

In this scenario, the depository bank with the original piece of paper is in the best position to see and detect ink being washed with acetone or scratched with razor blades.

They will see the smudges, see shadows of the original ink, feel the oily texture, feel the frayed paper.

The paying bank sees only a black and white Check21 Image.

To me, forged means the original writing on the original paper is fraudulent. Someone didn't mutilate and convert the original paper- whether that be altering the payee, amount, or signature.

What are your thoughts on this? Do you think members have standing to pursue the issue?

The check contains a forged maker signature. This is not an altered item and there is no breach under UCC § 4-208. Our review of other items involving this drawer demonstrates that this check was not signed by an authorized signor of the drawer. As a result, we decline to pay the claim.

*Snip from recent claim denial – original check washed and re-written/signed.*

**Response:** “Alteration” means (a) an unauthorized change in an instrument that purports to modify in any respect the obligation of a party to the instrument or (b) an unauthorized addition of words or numbers or other change to an incomplete instrument relating to the obligation of any party to the instrument. *See* N.D.C.C. § 41-03-44 (UCC 3-407). Based on the foregoing, I agree that the chemical washing or mechanical scratching of an *original check* and the addition of a new payee/amount constitutes an alteration of the same.

The term “forgery” is not defined in the UCC. However, the term “unauthorized signature” is defined as “a signature made without actual, implied, or apparent authority” and “includes a forgery.” N.D.C.C. § 41-01-09(2)(pp) (UCC 1-201). Courts also refer to counterfeit checks as “forged checks.” Counterfeit checks are replacements or copies of the original check and courts generally do not consider counterfeit checks to be altered checks.

In short, the determination of what type of fraud was committed (and who is liable) would likely come down to what facts can be established by the parties. I cannot give legal advice on whether members should “pursue the issue” in the event there is a dispute as to the type of fraud that has been committed. In such scenario, it would be recommended that you consult with your legal counsel about how your institution should best proceed.

**Question 2:** What is the obligation of the deposit or lending institution upon the incarceration of a borrower for an extended period of time (example 2 years or longer)?

Nothing – just allow the routine transactions to continue.

The institution needs to take action.

**Response:** If the borrower remains current on payments, the bank does not need to take action.

Things to keep in mind:

- Avoid taking action that could be construed as unfair, deceptive and abusive acts and practices (UDAAPs). In January 2022, the Consumer Financial Protection Bureau (CFPB) published a report, “[Justice-Involved Individuals and the Consumer Financial Marketplace](https://www.consumerfinance.gov/about-us/newsroom/cfpb-penalizes-jpay-for-siphoning-taxpayer-funded-benefits-intended-to-help-people-re-enter-society-after-incarceration/),” discussing unfair practices relative to incarcerated individuals, such as charging higher fees for basic financial products and services. As an example, a prison financial services company JPay was ordered to pay \$6 million in 2021 for its violations. See <https://www.consumerfinance.gov/about-us/newsroom/cfpb-penalizes-jpay-for-siphoning-taxpayer-funded-benefits-intended-to-help-people-re-enter-society-after-incarceration/>.
- The bank must still follow applicable consumer regulations if fraud or unauthorized activity is reported.

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### **CFPB Issues Steep Fine for Illegal Surprise Overdraft Fees**

The Consumer Financial Protection Bureau (CFPB) issued a [Consent Order](#) directing Navy Federal Credit Union to pay more than \$95 million for illegal surprise overdraft fees. Members were illegally charged overdraft fees in two ways:

- Even if there were sufficient funds in consumers’ accounts at the time the transaction was made, the credit union would charge consumers overdraft fees when their accounts had insufficient funds at the time the transaction *settled*. The CFPB noted that consumers could not know when a particular transaction would be settled, and many consumers believed that the funds transfer to the merchant occurred instantaneously rather than through a later settlement process.
- Until December 2020, the credit union did not disclose that there was a cutoff time after which peer-to-peer payment would not post the same day. However, the available balance would reflect the payment, so it reasonably appeared to customers that there were sufficient funds to cover all debits for that particular day. If the payment did not go through and there were insufficient funds, the credit union would charge an unanticipated overdraft fee.

Banks should review their overdraft policies and procedures, including all disclosures, for potential issues in light of this order.

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## **U.S. Department of the Treasury Releases National Strategy for Financial Inclusion**

The [National Strategy for Financial Inclusion](#) released by the U.S. Department of the Treasury on October 29, 2024, identifies the following objectives designed to increase access to financial products and services:

- Promote access to transaction accounts that meet consumer needs
  - Private financial institutions should expand the availability of affordable accounts tailored to meet the needs of underserved communities (e.g., [Bank On accounts](#)) and evaluate internal policies to allow for increased access for underserved communities.
- Increase access to safe and affordable credit
  - Financial institutions should collaborate with consumer reporting agencies and government agencies to integrate consumer-permissioned alternative data into credit scoring and underwriting models; expand Special Purpose Credit Programs; and improve default structures (e.g., forbearance).
- Expand equitable access to savings and investments
- Improve the inclusivity of financial products and services provided or backed by the government
- Foster trust in the financial system by protecting consumers from illegal and predatory practices

To learn more about the Strategy, view the [Fact Sheet](#).

## **The Small Business Lending Rule**

Back in 2023, the CFPB issued the small business lending rule, which implements section 1071 of the Dodd-Frank Act, amending the Equal Credit Opportunity Act (ECOA). The rule requires financial institutions to compile, maintain, and submit to the CFPB certain data on applications for credit for women-owned, minority-owned, and small businesses.

Due to ongoing litigation, the CFPB has issued an interim final rule to extend compliance deadlines as follows:

<b>Compliance Tier</b>	<b>Original Compliance Date</b>	<b>New Compliance Date</b>	<b>First Filing Deadline</b>
Tier 1 Institutions (highest volume lenders)	October 1, 2024	July 18, 2025	June 1, 2026
Tier 2 Institutions (moderate volume lenders)	April 1, 2025	January 16, 2026	June 1, 2027
Tier 3 Institutions (smallest volume lenders)	January 1, 2026	October 18, 2026	June 1, 2027

While the compliance dates and deadlines seem far away and litigation remains unresolved, banks should now be considering what will be required to meet the requirements of the rule.

### **SAFE Act Requirements**

The Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act) governs mortgage loan originators (MLOs). MLOs are individuals who take a residential mortgage loan application and offer or negotiate terms of a residential mortgage loan for compensation or gain. The term does not include individuals who perform purely administrative or clerical tasks on behalf of an MLO, real estate brokers (unless the individual is compensated by a lender, mortgage broker, or other MLO or their agents), or individuals or entities solely involved in extensions of credit related to time-share plans.

The SAFE Act requires MLOs to be licensed and registered using the Nationwide Mortgage Licensing System (NMLS) and to update and renew MLO information as applicable. Under the SAFE Act, banks are generally responsible to:

- Register and obtain a unique identifier;
- Ensure any employees who act as MLOs register, obtain a unique identifier, maintain that registration; and
- Implement written policies and procedures to help ensure compliance, including annual independent testing.

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### **Nacha ACH Rule Amendments – Fraud Monitoring**

As of October 1, 2024, Nacha has introduced updated rules aimed at improving fraud prevention, including the following:

- A receiving depository financial institution (RDFI) *may* return a transaction it thinks is fraudulent using the new Return Reason Code R17.
- An originating depository financial institution (ODFI) may use the Request for Return/R06 to request a return from the RDFI for any reason. Effective April 1, 2025, RDFI must advise the ODFI of its decision or the status of the request within 10 banking days of receipt of the request.
- RDFIs have an additional exemption from the funds availability requirements to include credit entries that the RDFI suspects are originated under false pretenses.
- Receiver is permitted to sign and date a Written Statement of Unauthorized Debits (WSUD) on or after the date on which the Entry is presented to the Receiver, even if the debit has not yet been posted to the account. (Current Rules require that the WSUD be dated *on or after* the Settlement Date of the Entry.)
- When returning a consumer debit as unauthorized in the extended return timeframe, RDFI must do so by the opening of the sixth Banking Day following the completion of its review of the consumer's signed WSUD.

These changes may require financial institutions to update their policies and procedures.

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### **Upcoming NDBA Events in 2024 and 2025**

NDBA has many exciting and informational events planned for 2024 and 2025. Below are some special dates to mark on your calendars!

- **Loan Documentation and Enforcement** | Early 2025 | Bismarck and Fargo, ND | details regarding registration and group pricing to be provided soon
- **Bank Management Conference** | February 12, 2025
- **Washington Summit** | March 17-19, 2025 | Washington D.C.
- **2025 Tri-State Trust Conference** | April 22-24, 2025
- **2025 Dakota School of Banking** | June 1-6, 2025 | Jamestown, ND
- **2025 Quad States Annual Convention** | June 9-11, 2025 | Rapid City, SD

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### **FDIC Digital Sign Rule Compliance by January 1, 2025!**

A friendly reminder that full compliance with the Federal Deposit Insurance Corporation (FDIC) amended regulation for use of the official FDIC name or logo ([12 C.F.R. Part 328](#)) is required by January 1, 2025. In part, the regulation requires banks to display a new “official digital sign” on bank websites, mobile applications, and certain ATMs and other similar devices. In addition, banks must note when a product or service is not FDIC-insured (“non-deposit signs”). Banks should carefully review the final rule and consult with legal counsel as to any questions arising in connection with compliance.

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### **Companies Must File Beneficial Ownership Information by January 1, 2025!**

A friendly reminder that the Corporate Transparency Act, enacted in 2021 to curb illicit finance, requires reporting companies created or registered to do business in the United States before January 1, 2024, to file an initial beneficial ownership information (BOI) report by January 1, 2025. Failure to comply with the reporting requirements may lead to civil and criminal penalties.

For more information about filing, visit <https://www.fincen.gov/boi>.

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