

Risk Allocation For Forged Checks: When Is A Check “Finally Paid” Under The Uncollected Funds Exclusion?

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I. Introduction

Exclusion (o), the Uncollected Funds Exclusion, of the Standard Form No. 24 Financial Institution Bond¹ precludes coverage for:

Loss resulting directly or indirectly from payments made or withdrawals upon a depositor's account involving items of deposit *which are not finally paid for any reason*, including but not limited to forgery or any other fraud, except when covered under Insuring Agreement (A).²

This exclusion typically applies where a customer deposits a check with his or her bank, which gives immediate credit on the deposit and submits the check to the payor bank for collection. The payor bank dishonors the check because it is forged and returns it unpaid to the depository bank, which debits the customer's account. By this time, however, the customer has withdrawn all funds and is nowhere to be found, leaving the bank with an uncollectible overdraft and, presumably, a loss caused by forgery. When the bank tenders a claim under its Financial Institution Bond for the amount of the check, the bonding company will decline coverage because the check was “not finally paid” by the payor bank, triggering the Uncollected Funds Exclusion.

The rationale for the Uncollected Funds Exclusion is that the insured bank is in the best position to prevent forgery or other fraud when accepting checks for deposit. If the bank inspects a check tendered for deposit and has doubts about or cannot verify an endorsement, the bank can place an extended hold on the check, extend overdraft privileges to a creditworthy customer to create a source of recourse in the event the check is returned unpaid, require collateral from the customer as a condition to paying on the check, or simply decline to accept the check on any terms. So long as the bank either does not pay its customer on the check or has recourse to customer assets by other means in the event the check is returned, then the payor bank's failure to pay on the check will not cause the depository bank a loss. If these internal controls fail and a forgery loss occurs, the bonding company will cover the loss. The risk is distributed between insurer and insured on the assumption that security measures will prevent the bank from parting with money absent recourse to the customer.

¹ Financial Institution Bond, Standard Form No. 24 (Revised Jan. 1986), *reprinted in* STANDARD FORMS OF THE SURETY ASSOCIATION OF AMERICA.

² Emphasis added.

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When, however, is a check “finally paid” such that a loss, no matter how rigorous the bank’s security measures aimed at preventing it, is not covered under the Financial Institution Bond by virtue of the Uncollected Funds Exclusion? The answer differs according to the kind of check and the body of regulation to which it is subject. Under the Uniform Commercial Code,³ “final payment” occurs when the payor bank pays on a check following presentment, even where this payment is expressly provisional or subject to being unwound later by enforcement of a warranty claim. By contrast, under United States Treasury regulations, final payment occurs after the payor bank, the Treasury, has mechanically inspected and paid on a check following presentment and after it visually inspects, usually much later, the check. Did the drafters intend that “final payment” under the Uncollected Funds Exclusion occur at the time the check is initially paid, even if payment is expressly conditional, for checks drawn on private banks, and long after the check is initially and conditionally paid, for checks drawn on the Treasury?

The Uncollected Funds Exclusion was drafted, and has been revised, to reflect an allocation of risk of loss under which the depository bank undertakes reasonable precautions at the point of deposit, and the bonding company covers losses where these precautions break down or prove insufficient to stop a fraud. In this article, the various interpretations of “final payment” applicable to private and public checks are discussed, to illustrate the disparate results yielded if this term is defined under the inconsistent bodies of regulation applicable to public and private checks, rather than according to ordinary usage. This disparity, and the relaxation of security exerted over checks as the volume of presentment and collection increases, suggest that the risk allocation intended by the Uncollected Funds Exclusion is being overlooked.

II. Intent of the Exclusion: Risk Allocation

A. THE EXCLUSION HAS EVOLVED AS THE NATURE OF BANK CONTROLS HAS EVOLVED

The Bankers Blanket Bond, Standard Form No. 24 (revised April 1969), excludes from coverage, under Exclusion (e), any:

Loss resulting from payments made or withdrawals from any depositor's account by reason of uncollected items of deposit having been credited by the Insured to such account, unless such payments are made to, or withdrawn by, such depositor or representative of such depositor who is within the office of the Insured at the time of such payment or withdrawal, or unless such loss is covered under Insuring Agreement (A) [concerning employee dishonesty or fraud].

³ U.C.C. § 4-215(a) (1990) [hereinafter U.C.C.].

Commonly referred to as the “Check Kiting Exclusion,”⁴ this provision was construed as applying to losses due to funds uncollected when a check kite collapsed.⁵ However, in response to growing recognition that modern banking practices created a broader range of risks associated with uncollected items of deposit, the Surety Association of America in 1976 appointed a subcommittee to study this exclusion and make recommendations for revisions to it. “In its 1976 Report, the subcommittee stated that ‘the exclusion may have been directed to a check kiting situation, but . . . it was not intended to apply exclusively to that situation.’”⁶ The subcommittee recommended that the exclusion be renamed the “Uncollected Funds Exclusion” and that the Form No. 24 bond be revised to include the following exclusion for:

[L]oss resulting from payments made or withdrawals from any depositor's account by reason of uncollected items of deposit having been credited by the Assured to such account, *whether or not such items are forged or altered in any respect*, notwithstanding the provisions of Insuring Clause 4 or subsection (e) of Section 1. EXCLUSIONS, unless such payments are made to, or withdrawn by, such depositor or representative of such depositor who is within the office of the Assured at the time of such payment or withdrawal, or unless such loss is covered under Insuring Clause 1.⁷

In 1980, when the bond form was revised again, Exclusion (o) took its current form, excluding “loss resulting directly or indirectly from payments made or withdrawals upon a depositor’s account involving items of deposit which are not finally paid for any reason, including but not limited to forgery or any other fraud, except when covered under Insuring Agreement (A).”⁸

⁴ See *Mitsui Mfrs. Bank v. Fed. Ins. Co.*, 795 F.2d 827, 830 (9th Cir. 1986) [hereinafter *Mitsui*]; *Clarendon Bank & Trust v. Fid. & Deposit Co. of Md.*, 406 F. Supp. 1161, 1170 (E.D. Va. 1975); *First Nat’l Bank of Miami v. Ins. Co. of N. Am.*, 495 F.2d 519, 522 (5th Cir. 1974); *Aetna Cas. & Sur. Co. v. Louisiana Nat’l Bank*, 399 F. Supp. 54, 56 (M.D. La. 1975).

⁵ One court has defined a check-kiting scheme as follows:

. . . [A] process whereby a person with a checking account in two banks can create an illusion of money in his accounts. A check drawn on the first bank is deposited with the second bank. Before the check reaches the first bank for payment, a check drawn on the second bank is deposited in the first bank. If the bank is willing to give credit in the interim, and many banks are if the person is a regular customer, the person can use the bank's money without first providing collateral and without paying interest. The scheme can go on as long as the person keeps on depositing checks in both banks and as long as the banks believe that there is money behind the checks.

Calcasieu-Marine Nat’l Bank v. Am. Employers' Ins. Co., 533 F.2d 290, 294 n.3 (5th Cir. 1976), *cert. denied*, 429 U.S. 922 (1976).

⁶ *Mitsui*, 795 F.2d at 830.

⁷ *Id.* at 829-30.

⁸ *Id.* at 830.

In 1969, this exclusion excepted from its purview all losses caused by uncollected checks where the customer is physically within the bank at the time of deposit, reflecting that the most effective loss-control method is the most obvious--making eye-to-eye contact with the customer. Bankers often refer to the first rule of loss prevention as "Know Your Customer." The "on-premises exception" to the Uncollected Funds Exclusion reflected an intent to shift the risk of uncollected funds losses to insurers where the insured employs this rule and loss occurs despite its observance.⁹

The evolution of this exclusion between 1969 and 1980 reflects a fundamental shift in risk allocation between insurers and banks, in recognition of the changing face of modern banking and the advent of judicial rules of interpreting insurance policies that are weighted in the policyholder's favor.

A check kite works only if both banks involved give immediate credit for a series of deposits covering a series of simultaneous withdrawals and if both banks exert no oversight at the point of deposit or withdrawal (such as contacting the drawee bank to compare deposit and withdrawal patterns). The kite collapses when one bank discovers the pattern of offsetting deposits and withdrawals and realizes that no real money supports them.¹⁰

Banks made themselves less vulnerable to check kites when they stopped posting daily transactions to hand-written ledgers and began inputting them in digital form, making information more readily available to the teller or operations officer analyzing a proposed deposit. Risk was reduced again with introduction of new and relatively simple internal controls, such as daily kiting suspect reports and large item reports, which allowed the teller or operations officer to perceive serial offsetting deposits and withdrawals by means other than memory. Moreover, as a more stringent regulatory scheme was reimposed upon financial institutions during the 1980s in the wake of the savings and loan bail-out, banks became less willing to waive holds on items of deposit and quicker to require overlying credit relationships and collateral as a condition to immediate credit. All of these controls worked to prevent loss by making kiting harder to accomplish. And, ironically, these internal controls prompted a generation of more sophisticated financial frauds employing checks as their hallmark.

At the same time, court decisions began challenging generally accepted notions of what was and was not covered under a Bankers Blanket Bond. Where a check accepted for deposit proved to be an uncollectible forgery, courts read the forgery insuring

⁹ "The rationale for the on premises exception is that banks should be encouraged to make arrangements for payment on uncollected items of deposit in face-to-face transactions at bank offices, and coverage is reinstated once a bank has taken this precaution." *Bay Area Bank v. Fid. & Deposit Co. of Md.*, 629 F. Supp. 693, 695 (N.D. Cal. 1986) (citing ABA Tort and Insurance Practice Section, ANNOTATED BANKERS BLANKET BOND 124 (Frank Skillern ed. 1980); *see also* *Bradley Bank v. Hartford Acc. & Indem. Co.*, 557 F. Supp. 243, 248-49 (W.D. Wis. 1983); *Bradley Bank v. Hartford Accid. & Indem. Co.*, 737 F.2d 657, 661 (7th Cir. 1984).

¹⁰ *Clarendon Bank & Trust*, 406 F. Supp. at 1171.

agreement broadly and the Check Kiting Exclusion narrowly so as to find coverage wherever possible.¹¹ Courts appeared to be warning bonding companies that, if they wanted to allocate risk for check-related losses between insured and insurer, the bond form should be revised to reflect that intent.

Ultimately, the “Check Kiting Exclusion” seems to have matured into the broader “Uncollected Funds Exclusion” based on a growing awareness among banks and bonding companies that the price of shifting to insurers the risk of loss on uncollected deposits was financial institutions’ investment in minimal internal controls at the point of deposit.

B. RISK ALLOCATION HAS NOT KEPT PACE WITH FUNDAMENTAL CHANGES IN THE NATURE OF BANK CONTROLS

Before electronic data entry, internal controls included visually inspecting of every check at the point of deposit, verifying customer endorsements, “knowing your customer,” and strategically using holds to control the risk of uncollectibility. The allocation of risk between bank and bonding company was consistent with the volume of transactions. Where basic security measures preventing withdrawal of funds before payment by the payor bank were in place, the bonding company covered the loss. Such losses usually were caused by professional forgery or by the misrepresentations of a customer that induced relaxation of controls.

In the modern banking world, internal controls have fundamentally changed, due largely to the sheer volume of transactions. Banks no longer visually inspect every check before accepting it for deposit; they “bulk process” checks over a certain minimum amount and accept the risk of loss that visual inspection would have detected. While banks verify customer and third-party endorsements, the increased sophistication of forgers and the widespread availability of scanning technology make forgeries and counterfeited checks more difficult to detect than ever before. To control this risk, banks establish credit relationships with their customers (such as granting overdraft privileges after an underwriting analysis) and require collateral and reserve accounts for merchants and other high-volume depositors of checks.

In today’s transaction-intensive banking environment, internal controls appear calculated more to minimize loss than to avoid it. Risk allocation has not kept pace with this evolution in internal controls. Bonding companies are still called upon to cover losses caused by professional forgers or by customer misrepresentations inducing relaxation of controls. This is so even when basic security measures that would have prevented withdrawal of funds before payment by the payor bank were not in place, or were modified to minimize rather than prevent losses. This assumption of risk, which

¹¹ *First Nat’l Bank of Miami v. Ins. Co. of N. Am.*, 495 F.2d 519, 522 (5th Cir. 1974) (forgery); *Clarendon Bank & Trust*, 406 F. Supp. at 1171 (withdrawal of funds attributable to dishonored checks); *Aetna Cas. & Sur. Co. v. Louisiana Nat’l Bank*, 399 F. Supp. 54, 56 (M.D. La. 1975) (withdrawal of funds credited by mistake).

banks claim they cannot avoid if they are to remain competitive, has not yet been reflected in their contractual relationship with the bonding industry. Moreover, risk allocation between insurer and insured that is driven by the kind of check presented, and not by its apparent collectibility, seems out of synchrony with one intent of the bond: to encourage and reward effective internal controls.

III. The Exclusion's Lynchpin: "Final Payment" of an Item of Deposit

A. "FINAL PAYMENT" UNDER THE U.C.C.

Where a check submitted for deposit is drawn on a private bank, a rigid, uniform system of foreseeable, though often harsh, rules apply to collection of the check. The Uniform Commercial Code defines the bank upon which a check is drawn and by which it is payable as the drawee or "payor bank."¹² Under U.C.C. section 4-215(a),

An item is finally paid by a payor bank when the bank has first done any of the following:

- (1) Paid the item in cash.
- (2) Settled for the item without having a right to revoke the settlement under statute, clearing house rule, or agreement.
- (3) Made a provisional settlement for the item and failed to revoke the settlement in the time and manner permitted by statute, clearing house rule, or agreement.

A bank may "settle" an item of deposit in the collection process either (1) in the manner "prescribed by Federal Reserve regulations or circulars, clearing house rules, and the like, or agreement; or (2) "[i]n the absence of that prescription," by the medium of "cash or credit to an account in a federal reserve bank of or specified by the person to receive settlement," the timing of which is treated differently depending on the medium of tender.¹³

Accordingly, under the U.C.C., final payment on a check occurs when the payor bank, upon presentment, (1) pays cash for the check; (2) finally "settles" the check through another medium, such as teller's check, cashier's check, or credit to a clearinghouse account, without any right to revoke the settlement; or (3) provisionally "settles" the check through some medium other than cash and later fails to timely revoke the settlement.

Assertion of a claim for breach of warranty does not affect the finality of the settlement. This claim may give the payor bank a right to recover a payment made in the

¹² U.C.C. § 4-105(2) (1990).

¹³ U.C.C. § 4-213(a) (1990).

course of a final settlement, if the presentment warranty was breached. U.C.C. section 4-302(a) requires the payor bank to pay or dishonor a presented check by midnight of the next business day or be liable for its face amount. Under subdivision (b), however, even if the payor bank incurs liability for the face amount of the check by failing to timely dishonor it, this liability “is subject to defenses based on breach of a presentment warranty (section 4-208) or proof that the person seeking enforcement of the liability presented or transferred the item for the purpose of defrauding the payor bank.” U.C.C. section 4-208(b) specifies the damages that a payor bank may recover from the presenting bank for breach of warranty.

The U.C.C. allocates risk to the party in the best position to prevent a fraud. The purpose of Article 4 of the U.C.C. is to impose strictly predictable commercial obligations upon the various parties in the collection process of a negotiable instrument and not necessarily to be fair.

Under the U.C.C., “final payment” occurs when the payor bank pays on the check following presentment, even though this payment may later be unwound through enforcement of a warranty claim. The U.C.C. makes “final payment” occur very early in the presentment process, to settle the item of deposit quickly and distribute the risk of loss predictably, subject to unwinding if forgery is discovered later.

Under U.C.C. 4-101(a), an overdraft by a bank depositor is treated as a loan from the bank to the depositor just as depositors with positive balances are considered creditors of the bank. New account agreements typically confirm that an overdraft will be considered an extension of credit.

If the mere existence of a payor bank’s right under sections 4-208 and 4-302 to assert breach of warranty claims following settlement of a check constitutes a statutory right to revoke the settlement, no item of deposit would ever be finally paid until all statutes of limitations on breach of warranty claims had expired, defeating the U.C.C.’s goal of creating a prompt and clear system of apportioning liability in the process of collecting on negotiable instruments. For this reason, items of deposit that are drawn on private banks and prove to be uncollectible, causing loss, are finally paid within the meaning of Exclusion (o) when their payor banks settled them in the normal collection process--not later, after breach of presentment warranty claims had become stale.

B. “FINAL PAYMENT” UNDER TREASURY REGULATIONS

United States Treasury checks¹⁴ and United States Postal Money Orders¹⁵ are subject to different law and regulation. The customer deposits the check, and the depository bank presents it to the Treasury. The Treasury mechanically inspects the check or simply pays it. Sometime later, the Treasury performs a visual inspection of the

¹⁴ Hereinafter USTs.

¹⁵ Hereinafter PMOs.

check. If there is a forged endorsement, this is when the Treasury discovers it and returns the check to the depository bank under its right to reclamation.

The rationale for applying different rules, rather than those of the U.C.C., to allocate risk where the check in question was issued by the Treasury is that public checks are not private commercial paper. Risk is allocated to the party physically present at the point of deposit.

Under 31 C.F.R. section 240.6 and 39 C.F.R. section 111.1, the Treasury and the Postal Service may “reclaim” funds they previously paid to presenting banks on USTs and PMOs bearing forged endorsements. Reclamation is defined as “a demand by Treasury for refund of the amount of a check payment.”¹⁶ 31 C.F.R. section 240.3(c) provides as follows: “The Treasury shall have the usual right of a drawee to examine checks presented for payment and refuse payment of any checks. The Treasury shall have a reasonable time to make such examination.”

In contrast to the U.C.C.’s definition of “final payment,” 31 C.F.R. section 240.3(d) provides that checks “shall be deemed to be paid by the United States Treasury only after first examination has been fully completed.” The United States District Court for the District of Massachusetts has held that “the Treasury does not incur a legal obligation to pay Defendants’ refund until it is notified that the check has been presented and payment is authorized by the Secretary of the Treasury.”¹⁷ In that case, the court also noted that the U.C.C. and other common law were inapplicable to questions of collection and payment of USTs because “[i]n enacting a specific body of law to govern the payment of treasury checks, . . . Congress manifests a clear intent to render these other bodies of law inapplicable.”¹⁸

Under Treasury regulations, “first examination” of a public check occurs when the Treasury has completed a full visual inspection of a UST, not just an electronic one, which may take well in excess of the midnight deadline prescribed by the U.C.C.¹⁹ The Treasury has a right to reclamation, the right to a refund of the amount of a check, “[i]f, after a check has been paid by Treasury, it is found to . . . (1) Bear a forged or unauthorized indorsement; . . .”²⁰ Reclamation based on a forged endorsement can be asserted after first examination and payment of the check.²¹

¹⁶ 31 C.F.R. § 240.2(l) (2002).

¹⁷ *United States v. Commonwealth Energy Sys.*, 994 F. Supp. 80, 82 (D. Mass. 1998).

¹⁸ *Id.* at 82 n.2.

¹⁹ *Bank of Am. Nat’l Trust Ass’n v. Fed. Reserve*, 349 F.2d 565 (9th Cir. 1965), *cert. denied*, 382 U.S. 984 (1966); *cf.* 31 C.F.R. § 240.3(d) (2002).

²⁰ 31 C.F.R. § 240.6(a) (2002).

²¹ *Id.*

PMOs are subject to very similar regulations, including the right to reclamation after initial payment.²²

Nowhere in federal rules and regulations is the term “final payment” used in regard to collection of checks. This term is exclusive to the U.C.C., which federal courts have held does not apply to the collection of USTs and PMOs. As the Treasury has a right to reclaim funds paid to a depository bank where a check bears a forged endorsement, “final payment” on USTs and PMOs never occurs until the period within which reclamation must be asserted. For USTs, that is one year from the date of payment;²³ for PMOs, within a reasonable time.²⁴ A contrary argument can also be made that the Treasury’s assertion of a demand for a refund based on a forged endorsement does not revoke its prior payment of a check, but rather creates a cause of action for damages in the check’s face amount plus interest.

No case authority addresses whether reclamation is in the nature of a rescission of the payment transaction that takes place before a check is deemed to have been finally paid. Bank will contend that courts should look for guidance to the U.C.C., which more clearly indicates that breach of presentment warranty is a claim that may be asserted following “final payment” of a check. Insurers will contend that the U.C.C. has no bearing on federal law and regulation and will point to the ease with which the Treasury can perfect its reclamation claim, that is, by, in effect, summarily rejecting a depository bank’s protest of reclamation and simply debiting its account at the Federal Reserve.

In short, unlike the private payor bank that is deemed under the U.C.C. to have finally paid on a check even if it bears a forged endorsement and is subject to later disgorgement, the Treasury is deemed under its regulations to have finally paid on a check only when it has actually inspected and made a conscious decision not to reclaim the instrument.

C. WHAT HAPPENS WHEN THE UNCOLLECTED FUNDS EXCLUSION IS CONSTRUED ACCORDING TO THE BODY OF REGULATION APPLICABLE TO THE ITEM OF DEPOSIT?

Most would agree that the Uncollected Funds Exclusion excludes the insured’s loss when the Treasury pays on a check and later visually inspects it and discovers a forged endorsement and returns the check and demands reclamation. Treasury regulations are intended to make it very easy for the Treasury to recoup public funds, outside the sometimes harsh risk allocation framework of the U.C.C. Under these regulations, “final payment” is pushed back to a date late in the presentment process, to effectuate this intent, allowing the Treasury to recoup funds up until the moment it decides to make a final payment. “Final payment” within the meaning of the regulations

²² See 39 C.F.R. § 111.1 (incorporating by reference a Postal Service publication referred to as the Domestic Mail Manual (“DMM”); DMM Issue 55 (dated July 13, 2000), § S020.3.4).

²³ 31 C.F.R. § 240.6 (2002).

²⁴ DMM § S020.3.2.

occurs simultaneously with the Treasury's decision that, having inspected the check and found no forgery, its prior payment may be considered final.

Final payment under the U.C.C., by contrast, occurs long before the payor bank is allowed enough time to actually inspect a check and discover a forged endorsement and, therefore, occurs much earlier than its ultimate decision to allow its initial payment to stand or to assert a presentment warranty claim.

Does it make sense to read the Uncollected Funds Exclusion according to the regulations applicable to the item of deposit in question? Does "final payment" under the Uncollected Funds Exclusion automatically mean "final payment" as used in the U.C.C.?

It is useful to recall that the purpose of Article 4 of the U.C.C. is to impose strictly predictable commercial obligations upon the various parties in the collection process of a negotiable instrument. The bonding company is not one of these parties. The Financial Institution Bond is a private contract between private entities, represented in the drafting process by the Surety Association of America for the surety industry and the American Bankers Association for the financial institution industry. The obligations between the parties to the Financial Institution Bond are governed by private agreement, common law, and statutory and regulatory authority, but not the U.C.C. Nor is the Financial Institution Bond construed as a statutory bond in most jurisdictions.

What, therefore, would be the rationale for imposing a U.C.C. definition of "final payment" on the Uncollected Funds Exclusion?

IV. In Modern Banking, When Does "Final Payment," As a Practical Matter, Occur?

To the bank, a check is never finally paid until all statutes of limitations on breach of presentment warranty claims have expired. The customer account agreement makes this clear: for purposes of charging back returns against the customer's account, there is no time limit. Therefore, a check is finally paid for purposes of recovering the amounts of returned checks from the customer, even when final payment under the U.C.C. has already occurred, only when the bank is assured that no chargeback will be necessary. Until then, no payment on a check is impervious to reversal.

To the bonding company, it makes no difference whether a check is paid subject to a later claim for breach of presentment warranty, or paid subject to a reclamation right, or paid subject to a release of all rights and claims: "Final" means the stage in the payment or collection process at which no revocation is possible.

If the insured is doing business under circumstances in which all endorser's signatures are not verifiable or the verification process breaks down because the bank is not checking all signatures, such as during batch processing, then the bank accepts the

risk of not receiving final payment for an item of deposit. Reading the Uncollected Funds Exclusion to exclude coverage for any loss resulting from non-payment of an item of deposit, before or after initial payment thereof, does not seem unreasonable in light of this risk allocation.

On the other hand, an argument can be made that losses from initially paid but not ultimately paid items of deposit should trigger forgery coverage and should not be excluded because the Financial Institution Bond does not require the bank to visually inspect every endorsement or to refuse deposits of third-party checks absent adequate collateral.

The counter-argument is that (1) a loss on checks not inspected by the depository bank is not caused by and, therefore, did not “result directly from” forgery, as required under the Financial Institution Bond; and (2) the Uncollected Funds Exclusion says it excludes losses from items of deposit not finally paid for any reason, suggesting that, regardless of why final payment did not occur, the insurer assumes no risk of loss associated with unpaid or ultimately uncollected items of deposit.

As a practical matter, the time that “final payment” of a check takes place differs according to the issue involved. For purposes of when the funds conveyed by a check are deemed received for tax purposes, the date of final payment is the date the check is received, not the date that the check is paid by the payor bank.²⁵ For purposes of distributing among holders of commercial paper the risk of uncollectibility in a high-speed environment where foreseeability sometimes is favored over fairness, a check is deemed finally paid under the U.C.C. when the payor bank pays on the check following presentment, even though this payment may later be unwound through enforcement of a warranty claim. For purposes of distributing risk among insurers and financial institutions, where the best result for all concerned is the encouragement of reasonable controls over checks, the date a check is finally paid should be when payment is irrevocably in hand.

V. Conclusion

If the Uncollected Funds Exclusion is read *not* to exclude losses in which a check is initially paid but later recouped because of a forged endorsement, then “final payment” really means “initial payment subject to warranty claims” under the U.C.C. and, therefore, applies only to private checks. Under this reading, tied as it is to the definition of “finally paid” under the U.C.C., checks *not* subject to the U.C.C. are excluded. Under this interpretation of the Uncollected Funds Exclusion, different kinds of checks that are regulated under different laws are treated differently under the insurance contract.

²⁵ *In re Williams*, 269 B.R. 68, 72 (Bankr. M.D. Fla. 2001) (section 4215 sets forth “the rules for final payment of items between banks,” not the rules governing when a check is finally paid as between payor and payee); *see also In re College Bound*, 172 B.R. 399 (Bankr. S.D. Fla. 1994).

Was it the intent of the Surety Association of America and the American Bankers Association, when drafting the Financial Institution Bond, to establish a scope of forged endorsement coverage that differs according to the kind of check bearing the endorsement and the body of regulation to which it is subject? A better rationale would be that the intent was to construe “final payment” *not* according to the kind of check or the applicable regulations, but according to the commonly understood meaning of the term--when payment is irreversible and irrevocable.

It is respectfully submitted that if “final payment” under the Uncollected Funds Exclusion were construed not as a legal term of art, dependent on reference to inconsistent bodies of law, but according to the layperson’s understanding of the term, the true intent of the Uncollected Funds Exclusion would be restored: to place the risk of loss, notwithstanding security measures, squarely on the bonding company, and the risk of loss in the absence of effective security measures squarely upon the bank.