



IMAGE INDUSTRY BEST PRACTICES DOCUMENT

INVALID ROUTING NUMBER ISSUES

**VERSION 1.0
DECEMBER 2010**

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i3G: Image Industry Best Practices Document

Invalid Routing Number
Issues

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EXECUTIVE SUMMARY

Introduction

i3G is an industry group that examines issues relating to electronic check image clearing, processing and return in an effort to provide meaningful operational information to help enhance and improve the check clearing process through possible rule, regulatory and operational changes. During this process, i3G has identified specific issues with regard to retired or invalid financial institution routing numbers as detailed below.

Brief History of Financial Institution Routing Number Policy

In 1911, a routing number system was devised by the American Bankers Association (ABA) to identify and route checks, drafts and other negotiable instruments to the financial institution (FI) identified by such number. In the 1950s the ABA recognized the need to automate the process of handling and sorting checks, and worked with the Stanford Research Institute that developed the magnetic ink character recognition (MICR) line which contains the paying FI's routing number at the bottom of the check. By 1959, MICR technology was standard in the US banking industry. In 1976, a formal policy was established by a joint task force consisting of the ABA and the Federal Reserve to create formal policies and guidelines for assigning and administering FI routing numbers. In 1985, the ABA Routing Number Administrative Board was created to administer the policies and procedures associated with routing numbers (Routing Number Policy). Since such time, the Routing Number Policy has remained substantially the same.

RETIRED ROUTING NUMBERS

One of the key points of the Routing Number Policy is its coverage of the retirement of routing numbers in situations where an FI may no longer be eligible to maintain, or no longer needs a routing number. The Routing Number Policy states, in part:

A routing number will be retired if the bank is no longer eligible for the number or if the bank has no further need for the number. Three years after being designated as a retired number, the use of the number for presentment and settling of payment transactions should cease unless an extension has been granted by the Board.

Prior to 2009, the Federal Reserve's practice was to return checks written on invalid and/or retired routing numbers which were not supported by the paying bank, to the bank of first deposit. Most items containing an invalid or retired routing number were returned by the Federal Reserve to the depository bank in return cash letter files as non-eligible (treated as a non-cash item) in line with the Routing Number Policy. In 2009, the Federal Reserve changed its policy and began sending these items back to the depository banks as cash letter adjustments, or sending the items to the bank originally identified as the paying bank for presentment as a forward collection item. Sending these items back as adjustments or sending them to the FI that originally was assigned the now invalid or retired routing number has created delays in properly identifying these items and charging back an FI's deposit customer in a timely fashion.

Two main issues have been identified relating to the handling of invalid or retired routing numbers: 1) the inconsistent management of retired and obsolete routing numbers, and 2) the use of falsely-created, invalid routing numbers in combination with other accurate check digits in the MICR line. Both of these issues cause or contribute to delays in the return process and losses due to fraud.

With regard to the first issue, FIs have seen an increase in the presentment of items drawn on retired routing numbers. Once a routing number is officially retired pursuant to the Routing Number Policy via the ABA Routing Number Administrative Board, it may no longer be supported for processing and payment by the assigned FI. This results in items drawn on a retired routing number being identified as transit items by the FI previously assigned the routing number, causing the item to be cleared as forward collection rather than as a return to the depository bank.

In changing its policy, the Federal Reserve has effectively rendered the Routing Number Policy obsolete and of no value. The FI originally assigned such routing number continues to be responsible as the paying bank on any item containing such routing number in the MICR line, regardless of the fact that the routing number had been properly retired. As a part of its change in position, the Federal Reserve began adding retired routing numbers back into their sort patterns, causing items containing retired routing numbers in the MICR line to be sent to the FI in forward presentments instead of automatically returning such items to the depository bank. Paying bank FIs that now receive these items for payment need to modify their processes to flag and return the items by their midnight deadline. In response, FIs have begun to add on-us traps to identify checks using their retired on-us routing numbers and to move them to their returns department for disposition. This increases the volume of checks that an FI has to manage in its returns department instead of being automatically returned to the depository bank.

As FIs implemented their on-us traps, they also saw an increase in checks drawn on other FIs' retired routing numbers, as well as checks with never-issued routing numbers that otherwise contain accurate check digit or account number information in the MICR line. The correct routing number check digit can easily be calculated from a mathematical calculation that is published in the ABA's Key to Routing Numbers. Because of the inclusion of a valid check digit, these invalid and sometimes fraudulent items are not caught by most FIs' initial sort pattern edits. Typically, items using never-issued routing numbers would fall into most FI's transit ranges and be processed and sent to the Federal Reserve as the default clearing agent. Since the Federal Reserve maintains all active routing numbers in their sort patterns, these items using never-issued routing numbers are caught by Fed and returned to the depositing FI as adjustments, delaying the return of these items. In response to the increase in and identification of checks containing never-issued routing numbers or retired routing numbers of other FIs, FIs began to implement transit traps.

Possible Solutions: Traps

Identifying retired transit routing numbers could take the form of a "Negative Trap" or "Positive Trap". The following is a more detailed exploration of each option.

Negative Trap

Due to the lack of synchronization between the Federal Reserve, the ABA Routing Number Administrative Board, and FIs regarding handling checks containing retired routing numbers, it is advantageous for FIs to identify items containing retired routing numbers as early as possible during processing. A Negative Trap would consist of FIs maintaining retired routing numbers in Accuity's (the ABA's designated registrar for routing numbers) database in their sort patterns. Similar to an on-us trap, placing the transit checks into the Negative Trap would cause the checks to be delivered to the Bank of First Deposit/collecting bank returns department for disposition. The routing numbers in the Negative Trap would need to be refreshed as contemporaneously as possible with changes to the Accuity list. Each FI may want to consider setting a maximum volume threshold of adding individual routing numbers to their Negative Trap. The concept is that if large volumes of items are using retired routing numbers, the paying bank may still be honoring checks bearing this retired routing number. Currently, because retired routing numbers may still be actively used by a paying bank's customer(s) the industry needs to consider issues with possibly inconveniencing an FI's deposit customers by not accepting for deposit checks that have a high likelihood of being paid, even if they are drawn on retired routing numbers. Of course, FIs should be responsible for working

with Accuity and not retiring routing numbers their customers are still using on their check stock. The Routing Transit Policy should create a closed environment for authorized routing numbers similar to the ACH and Card payment systems

A major advantage of a Negative Trap is that it can be implemented quickly. For most FIs, implementation can be accommodated with sort-pattern changes with no additional software development needed. A major disadvantage of a Negative Trap is that it will not identify fictitious/invalid routing numbers or routing numbers retired before 1987 (collection of historical data for retired routing numbers began in 1987). Older retired routing numbers will continue to hit the valid transit ranges and process, assuming they have a valid high order four digits (i.e., Fed Routing Code).

Positive Trap

A Positive Trap would consist of FIs creating a database of all active routing numbers and checking incoming files against this database. Checks that have no match on the routing number field could be sent to a Positive Trap pocket or sent to remediation (the benefit of first sending to remediation is to correct and lower the number of misreads a returns department needs to correct and reclear versus returning). The ability to use a Positive Trap would be dependent upon Accuity maintaining an accurate and up-to-date list of all valid routing numbers and the use of that list by the industry and the Federal Reserve. As with the Negative Trap, in a Positive Trap the routing numbers should be refreshed as contemporaneously as possible when Accuity updates its active routing number list. Also like the Negative Trap, the Positive Trap should have a user-maintained table where non-active routing numbers with volumes over the desired threshold are listed and augmented to the Positive Trap list.

A major advantage of the Positive Trap is that it would identify invalid and never-issued routing numbers, addressing the recent fraud issue where fraudsters use numbers that have never been issued (rather than retired routing numbers) to cause delays in processing and return. A major disadvantage of the Positive Trap is that it would require software development, and therefore, take longer to implement.

i3G Recommendation: Due to the ease of implementing a Negative Trap, most FIs should consider implementing one immediately and evolving to a Positive Trap. This will provide the partial protection the Negative Trap offers while the more encompassing Positive Trap is developed by the processing FI.

Note: Regardless of whether a Negative Trap or a Positive Trap is used, industry experience suggests that misread/mis-keyed checks may constitute up to 10% of items currently found in an on-us trap and 50% of the items in a transit trap. Therefore, FIs and the Federal Reserve are encouraged to review all checks that may be captured in a Negative Trap or a Positive Trap and repair/re-clear misreads versus automatically returning all items.

Checks that are returned due to retired or otherwise invalid routing numbers are being returned by FIs with a variety of return reasons (e.g., account not found, not our item, wrong bank). There is no industry X9 return reason for retired or invalid routing number. Currently, the only code that generally corresponds to such a description is the X9 reason code of 'R': "Branch/Account Sold (Wrong Bank) – Divested Account, Not Our Item". i3G's position is that including this reason on an item with a retired routing number may be very confusing to customers. A more descriptive identifier would be beneficial to receiving FIs and their customers. Therefore, i3G proposes the use of "Retired or Invalid Routing Number". At times, such checks have recently been handled as non-cash chargebacks by the Federal Reserve. This has resulted in fraudulent checks being delayed in Research work queues.

CONCLUSION

To mitigate the risk of processing items drawn on retired or invalid routing numbers and the delays associated with returning these items under current processes i3G recommends the following:

1. Financial institutions should implement one of the Trap processes identified above. FIs should inspect items in the Trap for misreads/mis-keyed instead of implementing a Straight Through non-acceptance process.
2. A unique returns identifier for **Retired or Invalid Routing Number** should be adopted under the ANSI X9.100-187-2008 standard. This standard defines specific return reason codes to support proper electronic check exchange (ECE). This new return code would identify checks being returned due to a retired, obsolete, or otherwise invalid routing number
3. The ABA Board should modernize the Routing Transit Policy to create a closed environment for authorized routing numbers, similar to the ACH and Card payment systems.

Summary

With industry reliance on the MICR line data and high-speed automated check processing; only checks containing valid routing numbers in the MICR line should be allowed in the system. Unlike with ACH and wire transfers, the management and control over the FI routing numbers used for check payments is not a closed loop system. Furthermore, the Federal Reserve no longer acts as an intermediary in identifying items that do not have valid routing numbers early in the clearing process. FIs, the Federal Reserve, the ABA and Accuity should establish a closed-loop process so that only checks with valid routing numbers can be processed through the US banking system. FIs should establish Negative Traps, at a minimum, and ultimately set up Positive Traps to quickly and efficiently identify and handle checks with invalid routing numbers. Establishing a new Invalid Routing Number return identifier and treating these checks as monetary returns, will help facilitate a more expedited process. Early identification of non-active/invalid routing numbers should benefit the entire industry by reducing losses due to fraudulent activity that currently takes advantage of delays in processing such items.

ABOUT I3G

The Image Industry Interoperability Group, i3G, is a US financial services industry collaborative formed in 2008 by a small and diverse set of bank organizations with the mission to quickly solve for lingering exceptions and interoperability issues impeding check payment processing efficiencies. The group's goal is to eliminate a large percentage of industry processing exceptions with a few changes to industry operational practices and procedures. I3G members include Bank of America, The Federal Reserve Bank, Frost Bank, JP Morgan Chase & Co, Independent Community Bankers Association (represented by Midwest Independent Bank), Southwest Corporate Federal Credit Union, Sterling Savings, US Bank, and Wells Fargo. More information can be found about i3G and proposed industry solutions by visiting www.i3ggroup.com and [i3G's linkedin group page](#).

Other i3G best practices documents and industry efforts can be found on www.i3ggroup.com include:

- "Dealing with Duplicates" – An industry wide duplicate file notification system
- Bank of First Deposit Electronic Endorsements
- TIFF Tags
- MICR: Interrogating to populate X9.27 Record 25

CONTACT INFO

Contact the group by emailing info@i3ggroup.com.