

Insights

April Hoosier Banker: Key Risk Issues Every Treasury Management Officer Should Consider

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Treasury management agreements often remind me of the Winchester Mystery House.

The Winchester Mystery House is a beautiful, sprawling and bizarre Victorian mansion located in San Jose, California. The story goes that Sarah Winchester, reeling from the untimely deaths of her infant daughter and husband, William Wirt Winchester (whose father founded the Winchester Repeating Arms Company), consulted a medium.

The medium advised Mrs. Winchester that her family and fortune were being haunted by the spirits of American Indians, Civil War soldiers and others killed by the Winchester repeating rifle ??' a.k.a. "The Gun That Won the West." The medium instructed Mrs. Winchester to move West and build a great house for the spirits. So long as construction never stopped, the spirits would be appeased.

Thirty-eight years of uninterrupted construction, beginning in 1884, transformed a tidy, eight-room house into a rambling maze of a mansion with 160 rooms and nearly as many architectural oddities: a staircase that descends seven steps and then rises 11, columns installed upside down, stairs that lead to the ceiling, doors that go nowhere, and more.

For many financial institutions, their treasury, or cash management, agreements started out like the original, eight-room Winchester house: neatly constructed and limited in purpose, perhaps at first addressing basic ACH services. With the addition of each "room" ??' online business banking, positive pay, sweep accounts, lockbox, remote deposit capture ??' the agreements grew bigger and disjointed, perhaps even unintentionally conflicting, like stairs leading to a ceiling.

Such add-on drafting of treasury management agreements creates fraud, operational, regulatory and legal risks. A comprehensive review and update of your bank's treasury management and other related bank agreements can mitigate these risks and provide additional benefits to your bank, such as reducing fraud losses.

Reduce Fraud Losses

Are your bank's agreements structured to take advantage of changes in the law? With the exponential increase in wire and other electronic transfers between commercial accounts comes increased cyberrisk and the related risk of unauthorized transactions. The general rule is that the bank bears the risk of loss for fraudulent transfers from a commercial deposit account.¹ UCC Article 4A provides a key exception to this rule, but your bank's agreement must be properly structured to take advantage of it. If a bank and its customer have an agreement as to what constitutes a commercially reasonable security procedure,² the risk of loss for fraud shifts to the customer if the bank proves that it accepted a fraudulent payment order: good faith, and in compliance with the security procedure and any written agreement or instruction of the customer restricting acceptance of payment orders issued in the name of the customer.³ Also, if a bank has established commercially reasonable security procedures that a customer has declined to use, and the customer instead agrees in writing to be bound by payment orders issued in

its name and accepted by the bank in accordance with another security procedure, then the customer will bear the risk of loss from a fraudulent payment order. ⁴Thus, it is vitally important to ensure that your bank's treasury management agreement addresses security procedures, so that you can take advantage of the risk allocation rules of Article 4A.

Improve the Customer Experience While Shortening Time to Revenue

Are you using separate agreements for each treasury management service you offer, or did your bank start with a single agreement when it first launched ACH services, then tack on provisions over time so that it has become a rambling mansion of an agreement? Whether you are using separate agreements for each service offering or one long agreement that addresses all treasury management services, it can improve the customer experience to restructure the material into a master agreement, designed to include supporting addenda for each service offered. This structure will speed up initial onboarding and will simplify the addition of future services for the customer. Further, from an administrative and legal perspective, using a master agreement structure ensures that defined terms, standard terms and conditions, and security procedures are addressed consistently across all service offerings.

Ensure Legal Enforceability, and Manage Regulatory Risk

Does your bank's treasury management agreement:

- Accurately reflect its current service offerings?
- Dovetail with your deposit account and other bank agreements?
- Include provisions required by rules mandates or "recommended" by regulation?

It is not uncommon for a bank's treasury management agreement to be out of sync with its current service offerings. For example a marketing initiative results in an inadvertently architected "upside down column" in the treasury agreement, which refers to the bill pay service as "PayEase," but the business unit is selling a service called "EasyPay." In some cases, a service is discontinued, yet is still addressed in the agreement. More often, a service is added or a functionality is changed, but the agreement does not address it.

This confusion creates legal risk. If the agreement does not properly address the service and the related obligations the customer is assuming, the legal enforceability of the agreement is called into question, not only regarding the customer's obligations, but also regarding general terms and conditions that protect the bank.

It is also common that a bank's treasury management agreement does not dovetail with its deposit account agreement and/or online banking terms and conditions, and this situation likewise creates legal risk. For example if the security procedures detailed in the treasury management agreement differ from those indicated in the online banking terms and conditions, which version of the security procedures prevails? The issue may impact the bank's ability to avoid a fraud loss under the risk allocation provision of UCC Article 4A.

There is regulatory risk as well. If your bank's treasury management agreement does not accurately reflect all services, it may fail to include provisions mandated by applicable rules. For instance National Automated Clearing House Association (NACHA) rules require, among other provisions, that a bank audit its customer's compliance with ACH rules.⁵ Your bank's treasury management agreement should expressly grant this audit right.

Furthermore, the treasury management agreement, if not updated, may fail to follow recommended regulatory guidance. As an example, the Federal Financial Institutions Examination Council has issued guidance on Remote Deposit Capture ⁶(RDC) that recommends that a treasury management agreement contain numerous contractual provisions that address the parties' respective roles and responsibilities

such as: procedures regarding handling and record retention of RDC information, types of items that may be transmitted, and aggregate limits on daily deposits. It is advisable to heed such guidance because today's "recommended" guidance will likely become required within one or two examination cycles.

While the architectural oddities of the Winchester House have created a tourist attraction, the drafting oddities of treasury management agreements create fraud, operational, regulatory and legal risks. By updating your bank's treasury management agreement and by ensuring consistency with other bank agreements, you can reduce fraud losses, improve the customer experience while shortening time to revenue, and ensure legal enforceability and manage regulatory risk.

¹ U.C.C. §4A-204 (Unif. Law Comm'n 1989).

² U.C.C. §4A-201 (Unif. Law Comm'n 1989).

³ U.C.C. §4A-202(b) (Unif. Law Comm'n 1989).

⁴ U.C.C. §4A-202(c) (Unif. Law Comm'n 1989).

⁵ NACHA Operating Rules & Guidelines, App. 8, Part 8.4. Part 8.4(a) provides a list of items that must be contained in an origination agreement.

⁶ Federal Financial Institutions Examination Council, Risk Management of Remote Deposit Capture (2009).