

CHECK CLEARING FOR THE 21ST CENTURY ACT

BENEFITS OF CHECK ELECTRONIFICATION AND THE CHECK 21 ACT

What Is Check Electronification?

Most paper checks today are physically delivered by the bank¹ in which the check is first deposited (the “depository bank”) to the bank on which the check is drawn (the “paying bank”). Delivering the paper check from the depository bank to the paying bank can involve numerous check sorting processes and multiple intermediary collecting banks as the paper check moves through the check collection process.

In order to make this check collection process faster and more efficient, financial institutions have been implementing check electronification programs. Check electronification is a general term that refers to various programs that convert or truncate a paper check to an electronic record during the check collection process.² Check electronification programs can take various forms, and generally include one or more of the following elements:

- *Check Image Truncation Programs.* The paper check is truncated (that is, converted) into a digital image as it moves through the check collection process. The image conversion can take place at the depository bank, the collecting bank or the paying bank. Images can be used both for the forward collection and check return processes. The original paper check is stored by the paying bank or one of the collecting banks, or is destroyed upon or some time after conversion.
- *Check Safekeeping Programs.* The paper check moves through the check collection process, and is collected and “safekept” by the paying bank or by another entity (such as the Federal Reserve or a correspondent bank) acting on behalf of the paying bank. The paying bank provides the customer with either a periodic statement describing the safekept check, or an image picture of the check.
- *Electronic Check Presentment (ECP).* The bank of first deposit or a collecting bank reads the MICR information off a paper check to create a separate electronic record that is sent to the paying bank. The original paper check either follows at a later date or is stored at the collecting bank. ECP can be used jointly with paper check collection, check image truncation and check safekeeping programs.

¹ The term “bank” includes state and national banks, savings associations and credit unions.

² The discussion of check electronification programs in this document does not include programs designed to convert a paper check to an automated clearinghouse (ACH) transaction at the point-of-sale or at a lockbox processing center. The Check 21 Act would not apply to these types of conversion programs.

What is the Proposed Check 21 Act?

The proposed Check Clearing for the 21st Century Act (the “Check 21 Act”) would facilitate the check electronification programs described above by authorizing a new type of paper document, called a "substitute check," that can be created from an electronic check image. The Check 21 Act would provide as a matter of law that the substitute check is the legal equivalent of the original paper check, and that the substitute check can be sent to a bank or other person in the absence of an electronic exchange agreement. Additionally, the substitute check would be designed so that it could be processed exactly as if it were the original paper check.

Today, checks can be imaged only if the paying bank and its customer have agreed to accept the image rather than the original paper check. The Check 21 Act and substitute checks will encourage banks to migrate to check electronification because they will be able, if they so choose, to convert all of their paper checks to images. The image would subsequently be converted to a substitute check when a particular paying bank or its customer has not agreed to receive images in lieu of the original paper check. It is anticipated that over time the number of paying banks that have not agreed to receive images will decline. The Check 21 Act would help bridge the gap to a fully electronic check collection system.

What Would Be The Check 21 Act’s Impact On Consumers?

As a practical matter, a consumer’s receipt of a substitute check, as opposed to the original check, should not have any impact on the consumer because a substitute check looks similar to the original check and retains all the information from the original check – including payee and drawer names, signatures, endorsements. Experience with existing check electronification programs -- which includes up to 30 percent of existing bank customers and substantially all credit union customers -- shows that consumers have very few complaints arising from receiving images or other alternatives to their original checks.

Additionally, as a legal matter, the receipt of substitute checks should not have any impact on consumers. The Check 21 Act would provide for the legal equivalence of the substitute check to the original check. The same protections provided to consumers today under the Uniform Commercial Code for paper checks would also apply to substitute checks. In addition, the Check 21 Act would provide additional legal protection to a bank customer in the form of (i) an indemnification for losses arising from the receipt of a substitute check instead of the original check, and (ii) certain expedited recredit rights for consumer customers.

What Are The Benefits Of Check Electronification Programs?

For Consumers and Businesses:

- By streamlining the collection and return processes, consumer and business depositors will have information about bad checks sooner and will be better positioned to collect from the check writer, thus reducing the amount of losses that depositors experience from bad checks.
- Financial institutions can provide new products and services to both consumer and business customers, such as on-line access and review of the customers' check images, thus significantly reducing the amount of elapsed time between the time when a customer makes a request for information about a check and when the customer receives the requested information. In addition to the timely receipt of information, the customer might also be able to print a copy of the check or send a copy of the check to a party questioning payment.
- Financial institutions can improve customer service by permitting the customer service representative to promptly access a check image and use it to respond to the customer's question and/or send it to the customer, thus providing much faster response to the customer's inquiry.
- Financial institutions could offer consumer and business customers broader variety of deposit options or extended deposit cutoff hours. For example, a greater number of remote ATMs could offer deposit taking because electronic processing would eliminate the need for the expensive daily physical pick-up at the ATMs.

For The Economy:

- The reallocation of resources from supporting transportation, storage and processing of checks allows those resources to be used to create quality, efficient products and services for bank customers.
- By reducing the dependence of the check payment system on transportation networks, negative economic impacts from unexpected disruptions to the air transportation system can better be avoided, whether caused by weather, natural disaster, terrorist attack or other types of crisis.

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