

**ELECTRONIC CHECK
PRESENTMENT: HERE IT
COMES**

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FEBRUARY 4-6, 2001**

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ELECTRONIC CHECK PRESENTMENT

- ECP W/PAPER TO FOLLOW
- TRUNCATION
- IMAGE
- NOT CHECK/ACH CONVERSION

ECP W/PAPER TO FOLLOW

- **PRESENTING BANK TRANSMITS INFORMATION ABOUT CHECK**
- **PRESENTING BANK DELIVERS PAPER CHECK SHORTLY THEREAFTER**
- **PAYING BANK MAY DEBIT CUSTOMER ACCOUNT BASED ON ELECTRONIC INFORMATION**
- **SETTLEMENT AS AGREED BY BANKS (PRIVATE SECTOR) OR UPON TRANSMISSION OF INFORMATION (FEDERAL RESERVE)**

ECP W/ PAPER TO FOLLOW

- ECCHO MEMBER BANKS EXCHANGING APPROXIMATELY 1.5 BILLION CHECKS PER YEAR WITH A VALUE OF APPROXIMATELY \$2.3 TRILLION
- FEDERAL RESERVE PROJECTING FOR 2001 PRESENTING 2.9 BILLION CHECKS, REFLECTING GROWTH OF ABOUT 17 PERCENT COMPARED TO 2000

TRUNCATION

- **PRESENTING BANK TRANSMITS INFORMATION ABOUT CHECK**
- **PRESENTING BANK SAFEKEEPS OR DESTROYS PAPER CHECK**
- **PAYING BANK DEBITS CUSTOMER ACCOUNT BASED ON ELECTRONIC INFORMATION**
- **SETTLEMENT UPON TRANSMISSION OF INFORMATION**

TRUNCATION

- ECCHO HAS DEVELOPED TRUNCATION RULES
- VIRTUALLY NO PRIVATE SECTOR TRUNCATION (YET)
- FEDERAL RESERVE PROJECTS ITS TRUNCATION VOLUME FOR 2001 TO BE 987 MILLION CHECKS, AN INCREASE OF ALMOST 10 PERCENT FROM 2000

IMAGE

- **PRESENTING BANK TRANSMITS IMAGE OF PAPER CHECK**
- **PRESENTING BANK SAFEKEEPS OR DESTROYS PAPER CHECK**
- **PAYING BANK DEBITS CUSTOMER ACCOUNT BASED ON IMAGE**
- **SETTLEMENT UPON TRANSMISSION OF IMAGE**

IMAGE

- ECCHO HAS DEVELOPED IMAGE RULES
- VIRTUALLY NO PRIVATE SECTOR IMAGE EXCHANGES (YET)
- FEDERAL RESERVE PROJECTS ITS IMAGE VOLUME FOR 2001 TO BE 1.5 BILLION CHECKS, AN INCREASE OF ALMOST 27 PERCENT FROM 2000

CHECK LAW DEVELOPMENTS: OVERVIEW

- **LEGAL SUFFICIENCY OF ELECTRONIC RECORD**
- **ELECTRONIC RETURNS**
- **FED DEFAULT TRUNCATION RULES**

Legal Sufficiency

- **Legal sufficiency of electronic record of check necessary to move beyond ECP w/paper to follow:**
 - **Bank investment**
 - **Federal Reserve support**
 - **Market acceptance**

Legal Sufficiency

- **National Conference of Commissioners on Uniform State Laws (NCCUSL) recently (July 1999) approved for state enactment draft model state legislation -- the Uniform Electronic Transactions Act (UETA) -- to among other things legally validate electronic records**
- **NCCUSL sponsors UCC, but UETA is not part of UCC**

Legal Sufficiency

- **UETA Enactments (As Of December 2000)**

- **Arizona, California, Delaware, Florida, Hawaii, Idaho, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Michigan, Minnesota, Nebraska, North Carolina, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Dakota, Utah, Virginia**

- **UETA Introductions (As of December 2000)**

- **Alabama, Colorado, DC, New Jersey, Vermont, West Virginia**

Legal Sufficiency: UETA

- **UETA validates electronic records**
 - **An electronic record may not be denied legal effect, validity or enforceability because it is an electronic record**
 - **A law that requires a record to be in writing is satisfied by an electronic record**
 - **If a law requires a record to be present or retained in original form, an electronic record meets that requirement**

Legal Sufficiency: UETA

- **If a law requires retention of documents, records, or information, that requirement is met by retaining an electronic record**
- **In any legal proceeding, the rules of evidence cannot deny admissibility of an electronic record on the ground that it is an electronic record or that it is not in its original form**
- **A person can enforce rights on an electronic record in the same manner as with the original document**

Legal Sufficiency: UETA

- **UETA expressly recognizes that electronic records of paper checks are within scope of UETA**
 - **Section 103 Commentary states that an electronic record of a check is covered under the UETA**
 - **Section 111(e) provides that if a law requires the retention of a check, that requirement is satisfied by the retention of an electronic record of the information on the front and back of the check**

Legal Sufficiency: UETA

- **UETA does not authorize electronic negotiable instruments**
- **UETA expressly provides that it does not make the amendments to UCC Articles 3 and 4 necessary to authorize electronic negotiable instruments**
- **For coverage under UETA, check must start out as a paper check and be converted to electronics during check collection**

Legal Sufficiency: Federal Law

- **UETA does not address status of electronic records of check transactions for federal law purposes (e.g., federal tax law, bankruptcy law)**
- **UETA not yet enacted in all states**
- **Possibility of state variations in enactment or interpretation**
- **Federal law companion to UETA necessary to provide electronic check records legal sufficiency for federal law purposes and ensure nationwide uniformity**

Legal Sufficiency: Federal Law

- **Electronic Signatures In Global And National Commerce Act (E-SIGN)**
 - **Enacted into law in July 2000**
 - **Electronic record may not be denied legal effect, validity or enforceability solely because it is in electronic form**
 - **If a law requires a record to be in writing, an electronic record satisfies that law**
 - **If a law requires the retention of a check, that requirement is satisfied by the retention of an electronic record of the information on the front and back of the check**

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Legal Sufficiency: Federal Law

- **Electronic Signatures In Global And National Commerce Act (E-SIGN ACT)**
 - **Preempts state law unless state adopts UETA as approved by NCCUSL**
 - **Excludes wills, trusts, estates, family law matters, court pleadings, termination of utilities, foreclosure of primary residence, cancellation of health/life insurance, product recalls, hazardous materials**
 - **Excludes electronic negotiable instruments**
 - **Commerce Department to study exclusions**

Electronic Returns

- **Check electrification programs (check truncation, check image) may not be operationally or economically viable, unless an image or other electronic or paper copy of the original paper check is returned, in lieu of the original paper check**
- **Absent electronic returns, the several billions of dollars of operating cost reductions, fraud avoidance and other benefits estimated to result from check truncation, check imaging and other check electrification programs may never be realized**

Electronic Returns

- **Regulation CC previously appeared to prohibit electronic returns in the context of private-sector check electrification programs**
- **Regulation CC Section 229.30(f) and 229.31(f) Commentary previously stated that an electronic return is not permitted if the check is merely difficult to retrieve from a filing system or from storage by a keeper of checks in a truncation system (UCC appears to authorize electronic returns in these instances)**

Electronic Returns

- **Regulation CC Section 229.37 did not permit this electronic return rule to be varied by clearing house rule as to persons not members of the clearing house, such as a check payee (UCC authorizes clearing house rules to bind all parties interested in the check)**

Electronic Returns

- **Effective December 15, 1999, the Federal Reserve Board amended Regulation CC to expressly provide that the paying or returning bank may agree with the depository bank to return checks via an image or other electronic return**
 - **Amendment does not affect rights of other parties interested in check who have not agreed to electronic return**
 - **Details of electronic returns left to private sector—Federal Reserve Board believes practices and standards will be developed most efficiently through commercial practice and market experimentation, rather than through government regulation**
- **ECCHO is developing rules for electronic returns. Rules anticipated to be completed during 2001**

FED DEFAULT TRUNCATION RULES

- **Fed is considering a new statute to:**
 - **Authorize banks to convert paper check into an electronic transaction (image)**
 - **Converting bank must present a MICR-encoded substitute check (image replacement document or IRD) in lieu of the image if the paying bank (or another collecting bank) does not agree to accept the image**

FED DEFAULT TRUNCATION RULES

- **Substitute check would contain substantially all the information contained on the original check, as well as any subsequent indorsements**
- **Substitute check would be machine-readable**
- **Image or substitute check would be legal equivalent of paper check**

FED DEFAULT TRUNCATION RULES

- **Paying bank required to recredit drawer on expedited next-day basis for amount of item plus interest if drawer has suffered a loss and original check necessary to establish validity of charge; and**
- **Collecting bank required to recredit paying bank for the amount of item plus interest if unable to provide the original paper check within 10 business days**

FED DEFAULT TRUNCATION RULES

- **Legal Issues Raised by Fed Truncation Proposal:**
 - **Proposal to apply only to checks truncated under the proposal?**
 - **Expedited recredit provisions to apply only to checks drawn by consumers?**
 - **Paying bank to recredit drawer only if it determines original check necessary to determine validity of charge to drawer's account? Can paying bank require documentation from drawer to make this determination? What period of time will paying bank have to make this determination?**

FED DEFAULT TRUNCATION RULES

● Legal Issues Raised by Fed Truncation Proposal (contd):

- **Paying bank right to obtain recredit from collecting bank only if it has made a good faith determination that original check necessary to determine validity of charge to drawer's account?**
- **Can paying bank withhold availability on drawer recredit? Until collecting bank provides recredit? Under what circumstances (new account, repeatedly overdrawn account, large dollar, emergency conditions)?**
- **Limitations on drawer's right to request original paper check initially or after a specified period of time (e.g., sunset after 3 years)?**

Legal Issues Raised by Fed Truncation Proposal

● Legal Issues Raised by Fed Truncation Proposal (contd):

- Effective date of Fed Truncation Proposal
- Federal or state law
- Migration to full electronification (no originals or substitute checks)? Fed study?

OPERATIONAL ISSUES RAISED BY FED TRUNCATION PROPOSAL

● **Operational issues raised by the Fed Truncation Proposal:**

- **Receiving bank receipt of images/substitute checks**
- **Duplicates**
- **Identification of converting bank**
- **Piggy back items**
- **Quality of images/substitute checks**
- **Customer inquiries**

OPERATIONAL ISSUES RAISED BY FED TRUNCATION PROPOSAL

- **Operational issues raised by the Fed Truncation Proposal:**
 - **Converting bank storage and retrieval of transit checks**
 - **Capacity to transmit images**
 - **Indorsements and return reason codes across multiple media**
 - **Converting bank full field repair**
 - **Representments**

CONCLUSION

- **COMBINATION OF MARKET AND LEGAL DEVELOPMENTS WILL RESULT IN EXPLOSIVE GROWTH OF ECP OVER NEXT 3-5 YEARS**
- **ARE YOU READY?**