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Electronic Banking: The Implementation of the Check 21 Act

Walter W. Eubanks, Government and Finance Division

November 9, 2004

Abstract. This report begins with a brief background of the check truncation issue, including a brief legislative history of the Check 21 Act. The next section discusses what Check 21 does and does not do. Next, it discusses the key rules and procedures of the Fed's final regulations. These rules range from the provisions governing the substitute check to the expedited recredit for consumers and banks. The report also examines consumer protection provisions that were incorporated in the law and those that were left out. The section on banks adopting electronic check clearing suggests that the costs will slow adoption, and the conclusion suggests that Check 21 is not likely to reduce paper check clearing significantly in the short run. Other methods of electronic payments, however, will reduce paper check clearing more rapidly.

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Electronic Banking: The Implementation of the Check 21 Act

November 9, 2004

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Electronic Banking: The Implementation of the Check 21 Act

Summary

On October 28, 2003, President Bush signed the Check Clearing for the 21st Century Act into law (P.L. 108-100, "Check 21 Act") to become effective on October 28, 2004. In the Check 21 Act, Congress gave the Board of Governors of the Federal Reserve System (Fed) the responsibility to prescribe regulations necessary to implement the provisions of the act. On July 26, 2004, the Fed published its final regulations for the Check 21 Act. The purpose of the act is to allow banks to take advantage of the potential cost savings of processing checks electronically. The final regulations facilitate the wider use of electronic check processing without demanding that any bank change its current check-collecting practices. It does this by authorizing the use of the substitute check. Check 21 makes a substitute check the legal equivalent of an original check for all persons and all purposes including any provision of federal or state law if a bank has provided the warranties, and if the substitute check: (1) accurately represents all of the information on the front and back of the original check at the time the original check was converted electronically, and (2) bears the legend, "This is a legal copy of your check. You can use it the same way you would use the original check." It is important to note that this law makes each bank financially responsible for any substitute checks it handles.

If a consumer suffers a loss due to the use of a substitute check, the consumer has the right to make a recredit claim, which the consumer may file with the bank holding his or her account. If the bank determines that the consumer's claim is valid, the bank will recredit the consumer's account for the amount of the consumer's loss, up to the amount of the substitute check, plus interest if the account is an interest-bearing account, no later than the end of the business day after the banking day on which the bank makes that determination. If the bank determines that the consumer's claim is not valid, because the substitute check for which the consumer made the claim was in fact properly charged to the consumer account, the bank must send notice to the consumer no later than the business day after the banking day on which the bank makes that determination.

This report begins with a brief background of the check truncation issue, including a brief legislative history of the Check 21 Act. The next section discusses what Check 21 does and does not do. Next, it discusses the key rules and procedures of the Fed's final regulations. These rules range from the provisions governing the substitute check to the expedited recredit for consumers and banks. The report also examines consumer protection provisions that were incorporated in the law and those that were left out. The section on banks adopting electronic check clearing suggests that the costs will slow adoption, and the conclusion suggests that Check 21 is not likely to reduce paper check clearing significantly in the short run. Other methods of electronic payments, however, will reduce paper check clearing more rapidly.

This report will be updated as legislative and financial developments warrant.

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Electronic Banking: The Implementation of the Check 21 Act

Background

The general purpose of the provisions of the Check Clearing for the 21st Century Act (Check 21 Act) is to allow banks to take advantage of the efficiencies and the potential cost savings of processing checks electronically. (The term *bank* as specified in the act is used to include commercial banks, savings institutions, credit unions, and the bank-like functions of the U.S. Postal Service and the U.S. Treasury.) The U.S. banking system processes more than 40 billion checks annually, but only a fraction of these checks is processed electronically. The cost savings of electronic processing are unknown, because estimates of the cost of using a check and the number of checks written each year remain in dispute. As a result, estimates of cost savings range from \$1.4 billion annually for truncation¹ alone to \$68 billion for replacing checks with fully electronic, straight through processing.²

Most of the savings from clearing checks electronically come from eliminating some or all of the handling, sorting, and physically transporting of checks to the paying bank. Under the law before Check 21, a bank that presents a check for payment must present the original check. The paying banks could get around this law, according to the Uniform Commercial Code (U.C.C.) sections 3-501(b)(2) and 4-100, by negotiating processing agreements that make it unnecessary to physically present the paper check. But, since the benefits of electronic check clearing are not uniformly dispersed among the participants, banks have found it difficult to obtain these agreements, thus constraining the widespread adoption of various forms of electronic check clearing. The most efficient form of electronic check clearing is one in which there is no paperwork in the process. This is called straight through processing (STP). The recipient of a check is paid electronically by debiting the payer's bank account as soon as the check is presented. The Check 21 provisions fall short of STP. Consequently, the cost savings are not as great as some other alternative electronic clearing processes, such as Internet bill-pay, or debit card payments.

¹Check truncation occurs when the check is stopped before it reaches the paying bank and the check clearing process is completed electronically. In some check truncation processes the paperwork is not eliminated. Following the electronic payment, the check is sent to the paying bank. If paperwork is required to complete the process, there will be less cost savings.

²See CRS Report RL31591, *Electronic Banking: The Check Truncation Issue*, by Walter W. Eubanks, and Joanna Stavins, "A Comparison of Social Costs and Benefits of Paper Check Presentment and ECP with Truncation," *New England Economic Review*, July/Aug. 1997, p. 33.

The Legislation

On December 17, 2001, the Federal Reserve Board (Fed) sent a proposed Check Truncation Act (CTA) to both the House Financial Services Committee and the Senate Committee on Banking, Housing and Urban Affairs. The Fed's proposed legislation would have authorized the creation of "substitute checks," an electronically produced instrument that allows banks to truncate the original check clearing process and complete the process with an electronically generated image replacement document (IRD), a substitute check. The customers would receive the substitute check, which would be the legal equivalent of the original check. The concept was supported by America's Community Bankers, the American Bankers Association, the Consumer Bankers Association, and the Financial Services Roundtable. They argued that the legislation would enable the industry to garner cost savings and speed up the check clearing process for consumers. The opposition to the bills came from the Consumers Union, supported in its testimony by the Consumer Federation of America, the U.S. Public Interest Research Group, and the National Consumer Law Center. They wanted consumers' accounts to be fully protected from disputes caused by the use of substitute checks. The consumer would be made whole while the dispute is being resolved.

On June 5, 2003, the House of Representatives passed H.R. 1474, the Check Clearing for the 21st Century Act of 2003 and sent it to the Senate Banking Committee. On June 27, 2003, the full Senate passed the Check Truncation Act of 2003 (S. 1334). The major differences between the bills were mainly in the area of consumer protection. The Senate CTA was more generous than the House bill in its consumer protection provisions. For example, S. 1334 gave consumers 40 days to file an expedited recredit claim, while H.R. 1474 would have given 30 days. In addition, the Senate's CTA shifted the burden of documentation more to the banks and less to consumers than the original H.R. 1474. The Senate incorporated its S. 1334 into H.R. 1474 before going into conference with the House. In conference, the House agreed to the Senate's changes and H.R. 1474 was passed by Congress. On October 28, 2003, President Bush signed the Check Clearing for the 21st Century Act into law (P.L. 108-100) to become effective on October 28, 2004. In the Check 21 Act, Congress gave the Fed the responsibility to prescribe regulations necessary to implement the provisions of the act. On July 26, 2004, the Fed published its final regulations for the Check 21 Act.³

Some of What the Check 21 Act Does, and Does Not Do

The Check 21 Act facilitates the wider use of electronic check processing without demanding that any bank change its current check collecting practices. It does this by authorizing the use of the substitute check, which is a new negotiable paper reproduction of an original check that contains an image of the front and the back of the original check, and is suitable for automated processing. It contains a magnetic ink character recognition line (MICR-encoded) in the same manner as the original check. Any bank that transfers, presents, or returns a substitute check warrants (or confirms) that (1) the substitute check contains an accurate image of the

³ See [<http://www.federalreserve.gov/boarddocs/press/bcreg/2004/20040726/default.htm>].

front and the back of the original check and a legend stating that it is the legal equivalent of the original check, and (2) that no depositary bank, drawee, drawer or indorser⁴ will be asked to pay a check that is already paid. A substitute check for which a bank has made these warranties is the legal equivalent of the original check for all purposes and all persons.

The Check 21 Act does not require any bank to use electronic check processing, receive electronic presentation, or create substitute checks, nor does it make electronic check images or electronic information the equivalent of the original checks. However, after October 28, 2004, any bank or other person that requires an original check must accept the substitute check as a legal equivalent in satisfaction of that requirement. Consequently, all banks are affected, even though they are not required to create substitute checks, or change their check processing equipment or practices. To illustrate, a bank that simply receives a substitute check created by another bank automatically warrants that substitute check when it tries to deliver that item for presentation, collection, or return to provide that item to its customer. As a result of the Check 21 Act, any bank that receives consideration for a substitute check or a presentation of a substitute check that it transfers, presents, or returns is also responsible for indemnifying⁵ any person who suffers a loss due to the receipt of that substitute check instead of the original check. Now that the Fed has released its final Check 21 regulations, all banks are required to provide a disclosure that describes substitute checks and substitute check rights to consumers who could receive substitute checks.

Key Implementation Rules and Procedures

Congress gave the Fed the responsibility to prescribe regulations as it “determines to be necessary to implement, prevent circumvention or evasion of, or facilitate compliance with the provisions of the Act.”⁶ On December 22, 2003, the Fed approved a proposed rule to amend Regulation CC, which regulates bank funds availability for check collection.⁷ The Fed added a subpart D that contains the requirements a substitute check must meet to be the legal equivalent of the original check. Subpart D covers the reconverting bank’s duties, the warranties and indemnities associated with the substitute check, expedited recredit for consumers and banks, liability for violations of part D, and the interaction between subpart D and existing federal and state laws. The Federal Reserve Board also proposed new model notices for consumer awareness disclosure and other consumer notices regarding substitute checks as required by the Check 21 Act. The following is a brief summary of a selection of these rules and procedures.⁸

⁴The Fed uses the word “indorse” as a variant of endorse throughout its regulations.

⁵The bank must make compensation for incurred losses, or damages.

⁶P.L. 108-100, sec. 15.

⁷ Regulation CC is the result of the Expedited Fund Availability Act of 1987 (EFAA), which established stringent check-hold rules.

⁸ Board of Governors of the Federal Reserve System, Regulation CC: Docket No. R1176, (continued...)

General Provision Governing Substitute Checks. For a substitute check to be the legal equivalent of an original check for all persons and all purposes including any provision of federal or state law, a bank must provide the warranties, and the substitute check must (1) accurately represent all of the information on the front and back of the original check at the time the original check was truncated; (2) bear the legend, “This is a legal copy of your check. You can use it the same way you would use the original check.”

The Reconverting Bank Duties. A reconverting bank is (1) the bank that creates a substitute check or (2) the first bank that receives a substitute check created by a person that is not a bank and transfers either that substitute check or the first paper or electronic presentation of the substitute check. This bank must ensure that the substitute check (a) bears all indorsements applied by parties that previously handled the check in any form (including the original check, a substitute check, or another paper or electronic representation of the original check or substituted check) for forward collection or return; (b) identifies the reconverting bank in a manner that preserves any previous reconverting bank identifications; (c) identifies the bank that truncates the original check.

Substitute Check Warranties. A bank that transfers, presents, or returns a substitute check for which it receives consideration warrants to any subsequent recipient, which could include a collecting or a returning bank, the depository bank, the drawer, the drawee, the payee, the depositor, and any indorser that (a) the substitute check meets the requirements for legal equivalent of the original check; and (b) no depository bank, drawer, drawee, or indorser will receive presentment or return of, or otherwise be charged for the substitute check, or the original check that was already paid.

Substitute Check Indemnity. A bank that transfers, presents, or returns a substitute check for which it receives consideration must indemnify the recipient and any subsequent recipient (including a collecting or returning bank, the depository bank, the drawer, the drawee, the payee, the depositor, and any indorser) for any loss incurred by any recipient of a substitute check if that loss occurred due to the receipt of a substitute check instead of the original check. In general, the amount of the indemnity depends on the nature of the breach. If the loss is caused by a breach of a substitute check warranty, the amount of the indemnity will be the amount of any loss (including interest, costs, reasonable attorney’s fees, and other expenses of representation) caused by the warranty breach. On the other hand, if the loss did not result from a breach of a substitute check warranty, the amount of the indemnity is the sum of the amount of the loss up to the amount of the substitute check and interest, expenses (including interest, costs, reasonable attorney’s fees, and other expenses of representation) related to the substitute check.

Comparative Negligence. If a loss results in whole or in part from an indemnified person’s negligence or failure to act in good faith, the indemnity amount

⁸(...continued)

Availability of Funds and Collection of Checks, Final Rules, [http://www.federalreserve.gov/boarddocs/press/bcreg/2004/20040726/attachment.pdf].

described above should be reduced in proportion to the amount of the negligence or bad faith attributable to the indemnified person.

Expedited Recredit for Consumers. A consumer may make a claim for reimbursement if the consumer acting in good faith, asserts that (a) the bank holding the consumer's account charged that account for a substitute check that was provided to the consumer (the consumer need be in possession of the substitute check at the time he or she makes the claim); (b) the substitute check was not properly charged to the consumer's account or the consumer had a warranty claim with respect to the substitute check; (c) the consumer suffered a resulting loss. The production of the original check or a sufficient copy is necessary to determine whether or not the substitute check in fact was improperly charged or whether the consumer's warranty claim is valid.

Procedure to File a Claim. The procedure for the consumer making a recredit claim begins with filing the claim with the bank holding his or her account. The claim should be submitted to the bank such that the bank receives the claim by the end of the 40th calendar day after the later of (1) the calendar day on which the bank mailed or delivered the periodic account statement that contains information concerning the transaction giving rise to the claim, or (2) the substitute check giving rise to the claim. The content of the claim should describe why the consumer believes his or her account was improperly charged for the substitute check or the nature of the warranty claim of the check. The claim should have a statement that the consumer suffered a loss and an estimate of that loss. It should also have the reason why production of the original check is necessary to determine whether or not the charge to the consumer's account was proper or the consumer's warranty claim is valid. Overall, the claim should have sufficient information to allow the bank to identify the substitute check and to investigate the claim.

If the bank determines that the consumer's claim is valid, the bank must recredit the consumer's account for the amount of the consumer's loss, up to the amount of the substitute check, plus interest if the account is an interest-bearing account, no later than the end of the business day after the banking day on which the bank makes that determination. The bank must send the consumer a notice that informs him or her of the amount of the recredit and the date on which the recredited funds will be available for withdrawal.

If the bank determines that the consumer's claim is not valid because the substitute check for which the consumer made the claim was properly charged to the consumer's account or that the consumer's warranty claim for that substitute check was not valid, the bank must send notice to the consumer no later than the business day after the banking day on which the bank makes that determination. The notice must include the original check or a sufficient copy, except where the consumer agrees to accept an electronic image of the original check or sufficient copy electronically (for example via the Internet).

Recredit Pending Investigation. If the bank has not taken any of the required actions described above before the 10th business day after the banking day on which the bank received the claim, it must by the end of that business day recredit the consumer's account up to the lesser of the amount of the substitute check or

\$2,500, plus interest on that amount if the account is an interest-bearing account. The bank must also send the consumer the notice mentioned above and recredit the consumer's account for the remaining amount of the consumer's loss, if any, up to the amount of the substitute check, plus interest if the account is an interest-bearing account, no later than the end of the 45th calendar day after the banking day on which the bank received the claim. Also, the bank must send to the consumer the required notice, unless the bank prior to that time has determined that the consumer's claim is or is not valid and therefore followed those required procedures in that circumstance.

Expedited Recredit for Banks. A parallel procedure for recrediting consumers is set up for recrediting banks. A bank may make an expedited recredit claim against an indemnifying bank, if the bank has received a claim for expedited recredit from a consumer with respect to a substitute check. The procedure is that the claimant bank sent its claim to the indemnifying bank such that the indemnifying bank receives the claim by the end of the 120th calendar day after the date of the transaction that gave rise to the claim. No later than the 10th business day after the banking day on which the indemnifying bank receives the claim, it must (a) recredit the claimant bank for the amount of the claim up to the amount of the substitute check, plus interest, if applicable; or (b) provide the information to the claimant bank regarding why the indemnifying bank is not obligated to comply.

Disclosure Requirements. Each bank is required to provide a brief disclosure statement to each customer who receives paid checks with a periodic account statement that describes a substitute check and its legal equivalency to an original check; and the consumer's recredit rights that apply when a consumer in good faith believes that a substitute check was not properly charged to his or her account. The disclosure statement must be distributed no later than the first regularly scheduled communication with the consumer after October 28, 2004. But the bank need not give separate disclosures to each customer on a jointly held account. These disclosure provisions were crafted to overcome potential consumer confusion about a process with few or no visible benefits for them.

Consumer Protection

Consumer protection was a critical consideration in the development of the Check 21 law from the Fed's initial legislative proposal in 2001. This is evident in the extensive provisions concerning warranties, indemnities and expedited recredits for consumers and banks. The strongest opposition to the Check 21 Act came from the Consumers Union (CU). Its views, in testimony, were supported by the Consumer Federation of America, the U.S. Public Interest Research Group, and the National Consumer Law Center. The CU argued that the act would make it impossible for an estimated 45.8 million U.S. households who are currently getting their paper checks back to continue to do so.⁹ CU stated that these consumers would

⁹U.S. Congress, House Committee on Financial Services, *Check Clearing for the 21st Century Act of 2003*, hearing, 108th Cong., 1st Sess. Apr. 8, 2003, unpublished, Statement of Janell Mayo Duncan, Legislative and Regulatory Counsel, Consumers Union, also (continued...)

be less protected from fraud under the Check 21 Act than under the existing check clearing process when there are disputes about errors in the check payment process. Consumers would no longer be able to verify their signatures and the accuracy of the amounts paid to payees from the original checks.

The Consumers Union suggested changes in the proposed legislation that would significantly increase consumer protection when checks are cleared electronically. These changes focused mainly on the recrediting procedure.¹⁰ First, the CU wanted to extend the recredit provisions in the act to all checks where the original checks are not returned to the consumer and there is a claim of improper payment or a warranty claim. This amendment would expand the indemnification coverage beyond the substitute checks in the Check 21 Act. It could extend coverage to more than 20% of all bank checks that are currently not returned to customers and more than 80% of credit unions' drafts that are also not returned to their members. Financial institutions opposed this extension because it would significantly raise financial institutions' cost of handling disputed checks and drafts. They argued that the protection was unnecessary and pointed to credit unions that have not returned checks since 1980 with almost no complaints or problems. The protection was not extended beyond the substitute check in the Check 21 Act.

Second, the Consumers Union argued that 10 days is too long for consumers to not have access to the disputed funds due to the use of the substitute check. It preferred the expedited recredit provisions in the Fed's original proposal that the disputed amount of the payment would be credited to the consumer's account by the close of the next bank business day after receiving the claim. The purpose of the provision is to reduce consumer inconvenience due to the use of the substitute check. However, the Check 21 Act provides for a recredit after 10 business days, which the banking industry argues is appropriate. In practice some banking analysts believe that most banks will recredit the accounts before the 10th business day.

Third, CU would have liked to raise the expedited recredit amount from \$2,500 to \$5,000. In H.R. 1474, disputed substitute checks for up to \$2,500 would be automatically recredited by the next business day while the dispute is being resolved. CU sought to have the expedited recredit limit raised to \$5,000 because the size of the amounts of these transactions is expected to increase over time. In addition, CU sought to shorten the number of days required to complete the overall recrediting process to less than 20 days. Financial institutions, on the other hand, prefer the longer time to clear up disputed checks in order to make sure that corrections are made accurately. These suggested changes, however, could significantly raise the cost to financial institutions to the point where it is no longer cost-efficient to adopt check truncation. In P.L. 108-100 the expedited recredit amount stayed at \$2,500.

⁹(...continued)

Supported by Consumer Federation of America, U.S. Public Interest Research Group and the National Consumer Law Center, [<http://financialservices.house.gov/hearings.asp?formmode=detail&hearing=204>].

¹⁰See [<http://www.consumersunion.org/finance/checkwc102.htm>].

A counter to the CU's argument for protection against processing errors is that in cases where check truncations have been used for years, processing errors are practically nonexistent and when they occur, they are quickly resolved. Asked by Senate Banking Committee Chairman Richard Shelby how many complaints she has received from credit union members about electronically produced copies of checks, the President and Chief Executive Office of the NIH Federal Credit Union, said that over a period of 14 years, she had received none. In response to a question from Senator John Sununu, the Vice Chairman of the Federal Reserve System said that in his seven years on the Fed board, he has never heard of a case in which checks were double-debited.¹¹

The Already Declining Use of Checks

The overall number of checks being written has been declining partly because the Fed is already truncating three million checks a day for its member banks¹² and additional checks are being truncated by private banking associations as well. However, the majority of banks use the traditional paper check clearing process. The Federal Reserve, with the largest single check clearing operation, closed 13 of its 45 check-clearing centers in 2003¹³ and announced plans to shut down nine more in 2005 and 2006. The Fed estimates that 2004's check processing will fall 9% from 2003's and a further 13% to 15% in 2005.¹⁴ As a consequence of the expected decline in the use of checks, the Fed has increased its fees for processing check by almost 8% to cover the increased cost per check cleared.¹⁵ The decline in the number of checks being processed is not due to the just implemented Check 21. But it is due to the growing popularity of alternative payment methods, including debit transactions and online payments. In addition, because of the rapid consolidation taking place in the banking industry more checks are being cleared inside the mega-banks as internal settlements. Of these alternatives the most significant is the growth in automated clearinghouse (ACH) transactions. ACHs are electronic payment systems that are run by the Fed and private banking organizations. They are mainly large volume electronic payment systems that enable corporations and consumers to make electronic payments. Payroll, recurring bill payments, and Social Security benefits are examples of typical ACH payments. Normally, ACHs send or receive

¹¹Richard Cowden, Consumer Groups Prefer Paper Checks, *BNA Daily Report For Executives*, No. 65, Friday Apr. 14, 2003, p. A-15. [<http://pubs.bna.com/nwsstnd/ip/BNA/BAR.NSF/2002090b92a4a3bc85256743006da1ea/2f92eebadf7bc66985256cff000fca1b?OpenDocument>].

¹² Patricia A. Murphy, "Check remains King Even in Face of truncation," *Check 21 from Paper to Imaging: A supplement to American Banker*, Nov. 2003, p. 9.

¹³ Bert Ely and Kimberly Hover, "Check 21 Spells the end of the Fed Check Processing" *American Banker Online*, May 21, 2004, p. 2.

¹⁴ Steve Bills, "ACH, Not Check 21, Cited in Fed's Check Decline," *American Banker Online*, Oct. 14, 2004, p.13.

¹⁵ Will Wade and Danian Platta, "New Fed Fees May Hasten the Inevitable," *American Banker Online*, Nov. 5, 2004, p.1., [<http://www.americanbanker.com/article.html?id=20041104482GTL4O&from=washregu>].

payments from payment centers.¹⁶ The wider use of ACH payments is the single most important reason for the decline in paper check processing.¹⁷

Banks' Adaption to Check 21

The Check 21 Act is not likely to significantly accelerate the decline in number of checks being processed in the near future. While more checks will be processed electronically under Check 21, the original checks will just be replaced by the substitute check after Check 21 is implemented. The major banks such as Citibank, Bank of America, and Wells Fargo are likely to increase their use of the substitute check at first. Because of the initial cost of devices used in producing the substitute checks or IRDs, experts expect that most smaller banks will not already have the installed technology to generate substitute checks, and the cost of acquiring the technology will stop them from participating in the Check 21 process. In 2003, an IRD cost about 5-10 cents an item, making the substitute check more costly to clear than a paper check right now.¹⁸ Some of the nation's largest banks are said to be budgeting \$100 million to 200 million for truncation hardware and software.¹⁹ For the typical smaller community bank the price tag runs between \$250,000 and \$400,000, according to several experts. In contrast, according to an Independent Community Bankers of America survey last year, most community banks (46%) had budgeted less than \$50,000 for 2004 technology spending.²⁰ Even though the cost of producing substitute checks is expected to decline rapidly, initial up front cost of clearing checks is expected to increase under Check 21.

Another reason for the higher cost initially is that banks are now using multiple presentment formats — paper, electronic, and IRD. The Fed and private check clearinghouses provide clearing services in all three formats. For banks receiving the substitute checks, back office paperwork operations, including the sorting, and handling is not eliminated. Even with Check 21, banks will still need their back office operations, and they may have to make additional investments in these back office operations to accommodate efficient management the substitute checks along with the original checks. Some bankers believe that they should wait until straight through processing (STP) becomes more popular. STP is an entirely electronic clearing environment that would combine checks into the same stream as debit and credit cards, ATM and point of sales clearing.

¹⁶ For more details, see CRS Report RL31476, *Electronic Payments and the U.S. Payments System*, by Walter W. Eubanks and Pauline H. Smale.

¹⁷ Steve Bills, "ACH, Not Check 21, Cited in Fed's Check Decline," *American Banker Online*, Oct. 14, 2004, p.13.

¹⁸ Michael P. Voelker, "Getting Ready for Check 21" *Check 21 from Paper to Imaging: A Supplement to American Banker*, Nov. 2003, p. 17.

¹⁹ Patricia A Murphy, "Time Banks Need to Get Ready for Check Truncation," *Check 21 from Paper to Imaging: A Supplement to American Banker*, May 2004, p. 28.

²⁰ *Ibid.*

Conclusion

The Check 21 Act establishes an electronic check clearing mechanism in which banks may voluntarily generate image replacement documents in place of checks. However, in terms of using and being responsible for the physical substitute checks, banks are mandated to participate in the new mechanism. Whether a bank employs electronic check clearing depends on how well it fits with the bank's business strategy. Bankers faced with expensive technology adoption costs would not be likely to adopt check truncation if their customers place a high value on the float and on receiving their canceled checks. Large banks with millions of checking accounts supported this legislation and are expected to be the greatest beneficiary of this law. Smaller banks would have to increase their technology spending far beyond what they do now with the expectation of capturing fewer benefits or savings than the larger banks. However, even some of these large banks, which are heavily invested in other forms of payment, such as Internet banking, and credit and debit cards that have electronic clearing processes, may view Check 21 as unwelcome competition. They may oppose initiating use of a substitute check themselves, and as the act is implemented many of these large banks may refuse to go beyond meeting their legal responsibilities in the new process. The new system may also confuse consumers who receive few or no visible benefits from it.

In sum, Check 21 places the check clearing process in a kind of a way station between paper check clearing and fully electronic processing. The latter is more efficient but is of concern to many consumers. Electronic clearing is also most welcomed by banks and recipients of funds, because it is faster and actually less prone to error. Over the years, the payment system has improved by adding MICR encoding to speed up the old system, and debit cards and online bill paying with other forms of payment. These additions have gained enough popularity to completely replace paper checks for some customers. Check 21 is yet another way to shift out of paper checks into electronic clearing. Many banks may not participate fully because Check 21 to them is too temporary to make the required investment now.