

## **Check Clearing for the 21<sup>st</sup> Century**

Schenck, Price, Smith & King, LLP

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The Check Clearing for the 21<sup>st</sup> Century Act (“Check 21 Act” or “the Act”) took effect on October 28, 2004 and is designed to enable banks to handle more checks electronically, which would make check processing faster and more efficient.

- The stated purposes of the Act are: (1) to facilitate check truncation by authorizing substitute checks; (2) to foster innovation in the check collection system without mandating receipt of checks in electronic form; and (3) to improve the overall efficiency of the Nation’s payments system. To do so, the Act sets forth a statutory framework under which a substitute check is the legal equivalent of an original check for all purposes, if the substitute check:

- accurately represents all of the information on the front and back of the original check as of the time the original check was truncated; and
- bears the legend: “This is a legal copy of your check. You can use it the same way you would use the original check.”

- A “substitute check” is defined by the Act as a paper reproduction of the original check that:

- (1) contains an image of the front and back of the original;
- (2) bears a “MICR line” or “magnetic ink character recognition line” containing all the information appearing on the MICR line<sup>1</sup> of the original check;
- (3) conforms, in paper stock, dimension, and otherwise, with generally applicable industry standards for substitute checks; and
- (4) is suitable for automated processing in the same manner as the original.

- Additionally, check truncation is defined by the Act to mean the removal of an original paper check from the check collection or return process and instead sending a substitute check or, by agreement, information relating to the original check such as the information taken from the MICR line or an electronic image of the original check.

- Thus, a person may deposit, present or send for collection or return a substitute check without an agreement with the recipient. Furthermore, the Act dictates that a bank that transfers a substitute check and receives consideration for the check must warrant to any transferee, any subsequent collecting or returning bank, the depository bank, the drawee, the drawer, the payee, the depositor and any endorser of the check that it meets all the requirements for legal equivalence and that it will not request payment on an item that has already been paid.

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<sup>1</sup> These terms refer to the numbers that are printed near the bottom of a check in magnetic ink in accordance with generally applicable industry standards.

- The Check 21 Act sets forth indemnity procedures, wherein any bank that reconverts or subsequently transfers a substitute check will indemnify against any loss incurred by the recipient of a substitute check if that loss occurred due to the receipt of a substitute check instead of the original check. The indemnity amount is based on whether or not there is a breach of warranty, and a comparative negligence standard is imposed.
- The Act sets forth a procedure for expedited recredits for *consumers* [as distinguished from claimant banks] in instances where a substitute check is improperly charged to an account. Claims for recredits must be submitted within 40 days unless the claimant is delayed due to extenuating circumstances such as extended travel or illness. The Act mandates that the recredit should be available by the start of the next business day after the business day on which the bank recredits the account.
- The Act further sets forth procedures for *claimant banks* against an indemnifying bank for expedited recredit if the claimant bank has received a claim for expedited recredit from a consumer, has suffered a resulting loss or obligation to recredit and production of the original check is necessary to determine the validity of the claim. Claimant banks have 120 days under the Act to submit a claim. Furthermore, the indemnifying bank then has 10 business days to provide the original check to the claimant bank, recredit the claimant bank for the amount of the claim or provide sufficient information as to why the indemnifying bank is not obligated to do so.
- A 1-year statute of limitations for actions to enforce a claim under the Act, beginning on the date that the cause of action accrues, defined as the date the injured party first learns, or by which such person reasonably should have learned, of the facts and circumstances giving rise to the cause of action.
- The Check 21 Act requires banks to provide notice to both existing customers and new account holders describing how substitute checks are the legal equivalent of an original check for all purposes and explaining consumer recredit rights under the Act.
- The Act supersedes any provision of Federal and State law, including the Uniform Commercial Code, that is inconsistent with the Act, but only to the extent of the inconsistency. Furthermore, any provision of section 8 of the Act, which enumerates the expedited recredit procedures for banks, may be varied by agreement of the banks involved, but no other provisions of the Act may be varied.
- The Check 21 Act also lays out annual review and reporting procedures for purposes of monitoring the effectiveness and efficiency of the Act.

### Implications of the Check 21 Act

The Check 21 Act will make check processing much faster over time, as banks can create substitutes for original checks which can be transmitted from one bank to another quickly and cheaply, and fewer originals will ever make it back to the issuing bank. Thus, the “float,” or delay between writing a check and having those funds debited from a bank

account, will diminish, as checks may clear as quickly as over one day under the new laws and regulations.

While the Check 21 Act does not require any bank<sup>2</sup> to create substitute checks or to accept checks electronically, it does require banks to accept a legally equivalent substitute check in place of an original check after the Act's effective date of October 28, 2004. Furthermore, even if banks choose not to create substitute checks, they will be subject to the new notice and disclosure requirements if they provide paid checks to consumer customers with periodic account statements or if they otherwise provide substitute checks to a consumer customer.

Helpful guidance for consumers regarding the new laws is available from the Federal Reserve Board at [www.federalreserve.gov/paymentsystems/truncation/faqs2.htm](http://www.federalreserve.gov/paymentsystems/truncation/faqs2.htm). The FDIC also provides helpful strategies for bank customers in its *Consumer News* publication, available at [www.fdic.gov/consumers/consumer/news/cnsum04/index.html](http://www.fdic.gov/consumers/consumer/news/cnsum04/index.html).

The Office of the Comptroller of Currency's Division of Legislative and Regulatory Activities will also provide guidance and can be reached at 202-874-5090.

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<sup>2</sup> Defined by 12 U.S.C. 5002 (2) as including (a) any depository institution; (b) any Federal reserve bank; (c) any Federal home loan bank; or (d) the Treasury of the United States, the U.S. Postal service, a State government; or a unit of general local government, to the extent that any of those institutions act as a payor.