

Check Clearing for the 21st Century Act Unofficially Known As (Check 21)

Check Clearing for the 21st Century Act (“Check 21”) became effective October 28, 2004. Check 21 allows financial institutions to convert a check into an electronic image of the front and back of the original check. Check 21 makes a properly prepared paper copy of an electronic check (called a “substitute check”) the legal equivalent of the original check for all purposes. Check 21 makes it voluntarily for financial institutions to create and send checks electronically to each other, but requires the acceptance of a properly prepared substitute check. Check 21 protects the consumer by providing a procedure if the consumer suffers a financial loss because the original check was transferred to an electronic image.

What is the purpose of the Check 21 Act?

Check 21 was enacted by Congress to facilitate efficiencies in the check clearing system that don't exist today.

Prior to Check 21, when a check is written, the check physically travels from the merchant to the merchant's financial institution, and then through a series of financial institutions until it reaches the financial institution on which the check is drawn. This process of transporting checks from one location to another is costly and inefficient.

How will Check 21 change this?

The Check 21 Act allows, but doesn't require, financial institutions to expedite the transfer of checks electronically, from the point when it is first written, to the financial institution that holds the consumers account, if they so choose.

What that means is that any financial institution in the check clearing process, beginning with the financial institution of first deposit, can create an electronic image of a check and thereafter transfer the check electronically.

Haven't financial institutions had the ability to create electronic images of checks in the past?

Financial institutions have had the technology to process checks electronically for some time. But up until Check 21, check law has not allowed for electronic images of checks to carry the same legal equivalency as the original check. Check 21 has resolved that issue.

Will financial institutions begin clearing checks electronically right away?

Some institutions may. But, before the industry can take full advantage of the new law, we must have standards in place that allow for the compatibility between the electronic systems that financial institutions use to create electronic images. Those standards aren't in place today, but are currently being developed.

How will consumers be affected?

Consumers may be affected in a few different ways. First, there will be a reduction in the “float time”. This is the time from when a check is 1st written, until it clears the consumer’s checking account. Checks have cleared faster in recent years, and this “float” will be further reduced when financial institutions across the nation are able to take full advantage of Check 21.

Additionally, if the consumer deals with a financial institution that returns cancelled checks back to their customers, they may occasionally receive what is called a “substitute check” with their other cancelled checks. A “substitute check” is a paper copy of a check that has been transferred to an electronic image.

Will financial institutions continue to return cancelled checks to their accountholders?

Some may for a while, but it defeats the purpose of the Check 21 law. Check processing can only become efficient if the paper is eliminated from the process. Returning cancelled checks puts the paper back in the system. Eventually this practice will probably be eliminated.

What will happen if a consumer deposits a check to their account that is returned unpaid?

Consumers may receive a “substitute check” if a check that is deposited doesn’t clear the account of the person that wrote the check. This may be because of non-sufficient funds, stop payment, closed account, or a variety of other reasons. At that point, if the check has been transferred to an electronic image, the consumer will receive a “substitute check,” which is a copy of the original check and, by law, is the legal equivalent of the original check.

How does the law protect the consumer’s rights?

The law protects consumers by providing an expedited re-credit procedure if the consumer suffers a financial loss because the original check was transferred to an electronic image.

The re-credit provision requires that consumers notify their financial institution within 40 days of the date that the statement was mailed that reflects the check in question, or within 40 days of the date that the consumer receives a “substitute check.” The institution must then investigate the claim within 10 business days or provisionally re-credit the consumer’s account, up to \$2,500, until the investigation is complete. The law provides a maximum of 45 days after the claim is filed for this purpose.

What effect do you expect Check 21 to have on consumer’s use of checks in the future?

Consumers may see little benefit in writing checks in the future. Once the check float is eliminated and cancelled checks are no longer returned, consumers may opt to use other, more convenient, methods of making payment, such as debit cards, electronic account debit, bill payment systems and especially credit cards if they still want to retain the float.