



Preparing for Check 21

December 2003

The Check Clearing for the 21st Century Act, commonly known as Check 21, will take effect October 28, 2004. The Federal Reserve is excited about the near- and long-term potential of this new legislation. Check 21 will spur the use of new technologies that will improve the efficiency and reduce the cost of the nation's check collection system and result in better services to bank customers for years to come.

"As a leading payments provider, the Federal Reserve is committed to working with the financial services industry to foster the payments system innovations that Check 21 should bring," says Fred Herr, senior vice president, Retail Payments Office, Federal Reserve Bank of Atlanta. "We intend to provide solutions that will help financial institutions capitalize on Check 21 efficiencies and pass the benefits along to their own customers."

Benefits of Check 21

More choices – By leveraging technology to take full advantage of electronic check collection and return capabilities, banks can offer an alternative to today's paper-based system.

Increased efficiencies – By reengineering their infrastructure with electronics, banks can expedite the collection or return of checks, streamline internal processes, reduce operating costs and realize greater efficiencies.

Greater innovation – By providing innovative new services, banks can broaden their deposit options or extend deposit cutoff hours.

Federal Reserve's Readiness for Check 21

The Federal Reserve is committed to providing high-quality check services to meet the changing needs of financial institutions, particularly in preparation for Check 21. Initiatives include:

• Upgrading Platforms and Technologies

The Reserve Banks have recently completed Check Modernization, which brings standard platforms nationwide for check processing and adjustments; a national FedImageSM Services archive; and robust online check services via FedLine[®] Web. These upgrades provide the Reserve Banks with more flexibility to deploy and adjust services based on customer needs and technology opportunities.

• Leading Development of Standards

The Federal Reserve has taken a leadership role in developing interoperability standards by working with industry contacts to assess how the Federal Reserve and other service providers will best position their operations to adopt common use of technical specifications.

New Check 21 Products

To accommodate Check 21, the Reserve Banks will introduce a suite of services to offer customers more options than ever before:

• Forward and Return Image Cash Letters

Customers with image-enabled operations will be able to send image cash letters directly to the Federal Reserve. These items can be quickly sent to the paying bank or to the local Federal Reserve for substitute check creation and physical presentation. Customers will also be able to send return image cash letters to the Federal Reserve, resulting in a more efficient process for return item pulls, return item qualification and cash letter creation.

For customers not yet image enabled, Reserve Banks will create image cash letters of selected items for expedited clearing, reduced operating costs and extended processing windows. Check 21 paper conversion will facilitate accelerated clearing of large-dollar items and improve deposit times.

• Image Cash Letter Delivery

Customers ready to accept image cash letters will be able to receive their Federal Reserve presentments earlier than would be possible with physical delivery of paper checks.

Frequently Asked Questions on Check 21

- Q. Does Check 21 allow banks to exchange checks electronically?**
- A.** Check 21 does not provide legal equivalence for image exchange, nor does it mandate image acceptance. The law does require banks to accept a new negotiable paper instrument called a substitute check, which can be used in place of the original paper check without an agreement in place.
- Q. Does Check 21 grant check images the same legal status as paper checks for clearing and settlement?**
- A.** No. The substitute check, not the check image, will serve as the legal equivalent to the original check.
- Q. Does Check 21 permit financial institutions to clear checks electronically rather than having to forward the original paper check?**
- A.** Electronic check presentment and image exchange will continue to be by agreement only. Check 21 is dependent on the use of image technology for the creation of substitute checks. As a result, it is likely that fewer physical items will be cleared between banks, reducing the industry's dependence on the physical transportation of checks.
- Q. Does Check 21 mandate check truncation?**
- A.** No. The law is designed to facilitate check truncation by removing legal barriers. Financial institutions may choose to truncate (and ultimately destroy) original paper checks, process and deliver checks electronically, and print substitute checks at a location near the paying bank for presentment to the financial institution. This market-based approach permits each financial institution to decide whether to make use of the new authority based on its business judgment of the costs and benefits of doing so.
- Q. Does Check 21 allow banks to truncate an item and convert it to an ACH item?**
- A.** No. While Check 21 encourages check truncation, the conversion of a check to ACH is outside the scope of the legislation.
- Q. Does Check 21 apply to money orders, controlled disbursements, and all government checks, including Treasury checks and state warrants?**
- A.** Yes. All checks, with the exception of foreign checks, are eligible for replacement with substitute checks. In addition, Savings Bonds are not checks and therefore are not subject to Check 21.
- Q. How will the Federal Reserve support consumer education about Check 21?**
- A.** As required by the legislation, the Federal Reserve Board is working to develop appropriate communications and safe harbor practices to support financial institutions' needs to communicate with their customers. The Federal Reserve will provide timely and accurate Check 21 information through publications and active participation in industry forums.
- Q. What specific Check 21 information will financial institutions need to provide to their customers?**
- A.** Before Check 21's provisions go into effect on October 28, 2004, banks should plan to prepare a consumer awareness notice targeted to individual consumers who receive original or substitute checks. The notice should explain how a substitute check is the legal equivalent of the original check and consumers' recredit rights under the law (see the Check 21 Legislative Overview for more information).
- Q. Should financial institutions buy image exchange software today to prepare for Check 21?**
- A.** Check 21 does not require financial institutions to purchase image exchange software. The legislation allows the paying bank to receive substitute checks as replacements for the original items. Financial institutions should complete a thorough assessment of how they plan to take advantage of the Check 21 authority before investing in image exchange software.

For more information about the Federal Reserve's Check 21 plans, or to discuss opportunities that could help your institution prepare, please contact your Financial Services Account Executive or visit <http://www.frbservices.org>.

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