

The Check Clearing for the 21st Century Act (“Check 21”)

Frequently Asked Questions

A. OVERVIEW OF CHECK 21

1. What is Check 21?

Check 21 is a new federal law that facilitates collection of electronic images of checks in place of the original checks. Banks that convert original checks to electronic images would truncate, and may destroy, the original checks. The Act authorizes a new negotiable instrument, called a substitute check, to replace the original check. A substitute check is a paper reproduction of the original check that is suitable for automated processing in the same manner as the original check. The Act permits banks to provide substitute checks in place of original checks to subsequent parties in the check processing stream. A downstream bank is not required to accept an electronic image, but must accept a substitute check, which is the legal equivalent of the original check.

2. Why was Check 21 created?

Historically, the transmission of drafts, checks and other negotiable instruments through the check collection process has been by physical delivery. The Federal Reserve Board promoted the Check 21 legislation after the shutdown of air transportation on September 11, 2001, which resulted in delays in paper check processing nationwide. Check 21 was created to foster innovation and efficiency in the nation’s check collection and payment system. Because banks are able to exchange substitute checks electronically, they reduce the time, risks and costs of paper check processing using physical transportation. Check 21 will also accelerate the check clearing process and result in a reduction of the “float time” between cashing and clearing checks.

3. What effect will the Check 21 Act have on check fraud?

Because of electronic processing, check clearing may take minutes rather than days which should result in irregular activity being detected and dealt with sooner.

4. When is the effective date?

The Act is effective on October 28, 2004.

5. What is a substitute check?

A substitute check is the legal equivalent of the original check if it meets the following requirements:

- ✓ accurately represents all of the information on the front and back of the original check as of the time the original check was truncated;
- ✓ represents the MICR line of the original check; and
- ✓ states that “This is a legal copy of your check. You can use it in the same way you would use the original check.”

6. Will the substitute check look different from the original check?

In many ways, substitute checks will look similar to the original check. They will be printed on regular check paper stock and contain the same information as the original check, including endorsements. However, there are some differences. The size of the substitute check will be reduced somewhat from the original and will include some additional information (e.g., information related to who truncated the original check and who converted the original check into a substitute check along with the statement set forth in the Answer to question 5 above).

7. What checks are eligible to become substitute checks?

All checks are eligible for conversion to a substitute check, including, but not limited to, consumer checks, commercial checks, money orders, treasury checks, and travelers checks.

8. Who makes the decision to generate a substitute check?

Any financial institution in the check clearing process can truncate the original check and create a substitute check.

9. What happens to the original check?

Banks are not required to keep original checks for any specific period of time. It is anticipated that the truncated checks will probably be destroyed.

10. Can a bank create a substitute check from an image of another substitute check?

Yes, as long as the formatting of the second substitute check conforms to industry standards.

11. Are debtors and trustees considered differently under the Check 21 Act?

Yes. For the purposes of Check 21, debtors would be considered “consumers” and trustees would be considered “customers.” The distinction is important because it affects each party’s rights and responsibilities under Check 21.

12. When will customers, including trustees, encounter substitute checks under Check 21?

Banks are not required to convert original checks to substitute checks. However, because of the potential cost savings, it is anticipated that most banks will eventually convert original checks to substitute checks. The conversion to substitute checks is expected to be a gradual process so that after October 28, 2004, customers may receive a combination of original checks, substitute checks and check images. While banks are not required to accept images under Check 21, many banks currently have image exchange agreements and those agreements are not impacted by Check 21.

13. Can financial institutions or customers “opt-out” of Check 21?

No. Under the Check 21 Act, no consent is required. Once an original check is converted into a substitute check, any person or bank must accept it as if the substitute check were the original check.

14. Does the Act require the acceptance of electronic images of checks?

No. The Check 21 Act only applies to substitute checks. Financial institutions are not required to accept electronic images of checks. Banks that have image exchange agreements in which they agree to accept images as between parties to the agreement are expected to continue to exchange images, however.

15. Does Check 21 replace existing Federal and state laws concerning checks?

No. Substitute checks fall under all laws applicable to the original check, including Federal Reserve Board regulations, and state law (UCC and state regulatory laws), except to the extent that provisions of applicable laws are inconsistent with the Check 21 Act.

16. How will the Act be implemented?

In July 2004, the Federal Reserve Board, after a comment period on their proposed rule, published their final rule on regulations to implement the Check 21 Act. The final rule is available on the Fed Board website at:

<http://www.federalreserve.gov/BoardDocs/Press/bcreg/2004/20040726/attachment.pdf>

17. Where should trustees direct their questions regarding Check 21 once the Act takes effect?

Questions should be directed to the United States Trustee. Additional information may be available from the trustee's bank and from the trustee's association (e.g., NABT, NACTT).

B. TRUSTEE-RELATED ISSUES

1. Does Check 21 impact the trustee's issuance of disbursement checks?

No.

2. Does Check 21 impact the misdisbursement process?

No, except trustees may need to get a substitute check to show that the creditor negotiated the original check.

3. What will trustees receive with their bank statements if an original check is truncated?

If an original check is truncated, trustees will receive either a substitute check or an electronic check image (front and back) with their monthly bank statement in place of that original check. Once an original check is truncated, customers are no longer entitled to demand receipt of their original paid check. The electronic image will be in the form of images printed on paper (no more than four checks, front and back – eight images total per statement page) or, for standing trustees only, may be furnished on CD-ROM.

4. If a trustee does not receive a substitute check back with the monthly bank statement and a payment dispute arises, will the bank provide a substitute check for the item?

Under the Check 21 policy statement, a bank will be required to provide a substitute check to a trustee upon request.

5. Will there be any change in the trustee's review of bank statements and reconciliation processes?

Yes. Chapter 7 trustees will need to review bank statements and canceled checks within 10 days of receipt, and reconcile bank accounts before the end of the following month. The review of canceled checks should include an examination of the MICR line and a general review of the items. If there are errors, alterations or unauthorized use of the Trustee's signature, trustees will need to report them to their banks within 30 days of their receipt of

the bank statement. A document entitled “Chapter 7 Trustee Bank Account Review and Reconciliation Procedures,” reflecting these and other changes, was distributed to Chapter 7 Trustees in September 2004.

Standing trustees should reconcile bank accounts monthly. Any unusual entries on the bank statements should be investigated. All returned items should be reviewed for errors, alterations, or unauthorized signatures. The trustee must, within thirty days of receipt of the bank statement, notify the bank of any such instances.

6. Is positive pay for chapter 13 trust accounts impacted by Check 21?

Yes. It is important that Chapter 13 trustee’s positive pay files be transmitted to the bank immediately after the trustee’s disbursement run because checks may clear faster in the future.

7. What procedures should trustees use if a canceled check image is illegible or shows evidence of alteration?

The trustee should obtain a substitute check or a larger image of the check for further investigation.

8. What happens if a duplicate charge or check, or other discrepancy is incorrectly charged to a trustee’s account?

The trustee should report the discrepancy to the bank within 30 days of receiving the bank statements.

9. Will deposited funds be available sooner if processed as a substitute check?

Not necessarily. The Act does not require that these time periods be accelerated.

10. What impact does Check 21 have on the TFR and TDR packages submitted by Chapter 7 trustees?

None. Chapter 7 trustees will continue to attach monthly paper bank statements and canceled checks (i.e., canceled original checks, substitute checks, and check images) to the TFRs and TDRs submitted to the United States Trustee.

11. What impact does Check 21 have on Trustee Handbooks?

Trustee Handbooks will be updated during 2005 to reflect Check 21.

12. Will the Act change any audit requirements?

The audits and field exams will be updated to reflect Check 21.

C. RELATED ISSUE

- 1. Although not covered by Check 21, a related issue concerns check conversion by creditors. For example, a major credit card company, with customer approval, converts a customer payment by check to an electronic funds transfer and does not return an imaged check to the customer's bank. What is the Program's policy in regard to check conversion by creditors?**

Trustees should not approve conversion of trustee checks to ACH transactions or electronic funds transfers. In addition, trustees should instruct their banks to refuse any attempts to make such debits to bankruptcy accounts. This does not apply to chapter 11 debtors-in-possession.