

REGULATORY ALERT

NATIONAL CREDIT UNION ADMINISTRATION
1775 DUKE STREET, ALEXANDRIA, VA 22314

DATE: October 2004 **NO:** 04-RA-12
TO: All Federally-Insured Credit Unions
SUBJECT: Check 21 Act

Dear Board of Directors:

The purpose of this regulatory alert is to inform credit union officials about *The Check Clearing for the 21st Century Act* (Check 21), which becomes effective on October 28, 2004.

Check 21 revises the clearing and payment system by enabling financial institutions participating in the system to process items electronically. For some credit unions, the act will require a mass mailing of disclosures in November. For most credit unions, the act will require an occasional distribution of disclosures.

Under the current clearing and payment system, an institution is not required to pay a check or share draft drawn on it until the institution receives the original item through the system. Under Check 21, any financial institution in the clearing and payment system can truncate the original draft (i.e. convert the original draft into a photocopy). The institution may then transmit the information in the draft electronically or can forward an image, front and back, through the processing system. The paper copy of the image is known as a substitute check. Any institution in the processing chain may elect to convert an original paper check or draft into a substitute check, which then travels through the system like an original paper item.

The substitute check is the legal equivalent of the original item. The printed substitute check will have the image of both the front and back of the original item. While the substitute check may be physically larger than the original check, the image will be smaller than the original.

Check 21 does not require that processors truncate, so it is possible that a member may receive an original cancelled share draft if requesting one (e.g., to provide proof of payment). While Check 21 is not mandatory for processors, credit unions and members do not have the option of opting out. If any financial institution in the processing system decides to truncate a draft, all institutions

down the line and affected members must accept the substitute check in place of the original draft.

Any credit union that is currently returning original cancelled share drafts to members with monthly statements will be required to send a disclosure to all members who are receiving cancelled drafts. The disclosure will advise the members that they may receive substitute checks with future statements. This disclosure is to be sent with the first regularly scheduled communication after October 28, 2004 and may be included in the members' regular monthly statement.

When credit unions return original drafts on an occasional basis, e.g., returned item or member needs an original to prove a payment, a general notice is not required. Instead, credit unions must provide a disclosure on each occasion that a substitute check is provided to a member. A disclosure must also be provided when an item deposited into a member's account is returned for non-sufficient funds and it is returned in the form of a substitute check.

Model disclosures are available on the Federal Reserve Board's web site. These samples begin on page 70 of the document located at the following link:
<http://www.federalreserve.gov/boarddocs/press/bcreg/2004/20040726/attachment.pdf>.

Check 21 provides that, under certain circumstances, a member who suffers a loss because of a substitute check may be entitled to an expedited recredit. For example, an expedited recredit may be available if a substitute check is paid for an amount different from the original item.

Credit unions are urged to educate their staff concerning the appearance of a substitute check, its legal equivalency to an original check, and the recredit process.

Should you have any questions about Check 21, please do not hesitate to contact your NCUA Regional Office or State Supervisory Authority.

Sincerely,

JoAnn Johnson
Chairman

File Name: s:\Staff Folders\EAH\RegAlert_Check 21_093004.doc
Bcc: Habring