

## Check 21 – Frequently Asked Questions (FAQ)

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Below is a list of frequently asked questions.

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Use of Terms: The term “substitute check” is used in Check 21 to identify the new negotiable instrument created by the Act; the term “Image Replacement Document” or “IRD” is defined in the industry standards developed for substitute checks. The IRD and substitute check are essentially the same.

### A. Purpose of the Act

A1.

Q. What is the purpose of the Act?

A. The primary purpose of the Act is to allow an institution to make a unilateral decision to truncate all paper checks without agreements with any other party. The Act enables this by authorizing the creator of a substitute check from an electronic record (image) of the check for those banks and customers who have not agreed to accept the electronic record (image).

A2.

Q. Does the Act require the acceptance of electronic records (images) of checks?

A. No. An institution is not required to accept electronic records (images) of checks.

A3.

Q. If an institution can unilaterally determine to truncate all paper checks and other institutions are not required to accept electronic records (images) of checks, how can this be accomplished?

A. The Act provides for the creation of a new paper legal instrument, substitute check, that is the legal equivalent of the original check for all purposes and that can be processed as if it were the original check. (Substitute checks defined below.) The substitute check can be created from the electronic record (image) of the check for those banks and customers who have not agreed to accept the electronic record (image).

A4.

Q. Are any checks not eligible for conversion to a substitute checks?

A. No. All checks are eligible for conversion to a substitute check. This includes, for example, but is not limited to consumer checks, commercial checks, money orders, travelers checks, treasury checks, etc.

A5.

Q. Does an institution have to accept substitute checks presented to it for collection or returned to it as unpaid?

A. Yes. Substitute checks are the legal equivalent of the original paper check for all purposes and all institutions must accept them as if they were the original checks.

A6.

Q. Can institutions or their customers “opt out” of Check 21?

A. No. Under the Act no institution or any its customers may “opt out” of the Act; they all must accept the substitute check in lieu of the original paper check. This includes all depository financial institutions (DFI) as defined by the Federal Reserve Act and includes every customer of a DFI. This includes, for example, but is not limited to consumer customers, corporate customers and governmental agencies.

## **B Scope of the Act**

B1.

Q. Does Check 21 provide legal rules or recognition for image exchanges between banks?

A. No. Check 21 provides legal recognition and equivalency for substitute checks only. Additional agreements and/or rules are required for image exchanges. The Act does not govern image exchanges, and therefore image exchanges still need to be performed under agreement between the parties.

B2.

Q. What is a substitute check?

A. A substitute check is a paper reproduction of an electronic record (image) of an original paper check that was previously truncated. Substitute checks must meet industry standards that include, but are not limited to, the standard paper weight and size for paper checks, full MICR line information to facilitate automated processing as if they were the original paper checks, all endorsements, etc. Substitute checks are designed to minimize the impact of check imaging on institutions and their customers that wish to continue to receive paper checks for processing and for their customers' statements.

B3.

Q. What is the relationship between check images and Check 21?

A. Check 21 authorizes the creation of the substitute check from images of the front and back of the original paper check. Check 21 complements image technology by enabling banks to unilaterally determine to truncate all paper checks and provide substitute checks to those banks and customers who have not agreed to accept the electronic records (images) of original paper checks.

B4.

Q. Does Check 21 require all checks to be truncated?

A. Check 21 does not require (mandate) that any check be truncated. The Act only allows for the production and legal equivalency of a substitute check for parties that choose to truncate the original check and replace it with a substitute check.

B5.

Q. Since the Act only covers substitute checks, what is the point of the Act and how will it help the banking industry?

A. The Act allows banks to make unilateral decisions to truncate all checks and replace them with substitute checks. The significance of Check 21 is not that it allows the conversion of one paper check to another paper check but rather that it encourages the use of technology to improve the overall efficiency of the check payment system. By promoting the use of image technology, the Act promotes the elimination of many costly processing steps. Under the Act, a depository bank could, for example, image capture a deposited check at the earliest point of entry into the bank, for example at the branch, and never process the original check again. For deposited on-us items for which the drawing customer wishes to receive paper documents in their statements, the depository bank (also paying bank in this example) could print substitute checks in the appropriate sequence at the time of statement preparation and no additional physical sorting would be required. Beyond Check 21, the use of image technology can facilitate the development of numerous improvements to bank operations and also for new or improved customer products and services.

B6.

Q. Does the Act apply to all types of customer accounts or to only consumer accounts?

A. Every check is eligible for conversion to a substitute check and the Act applies to every check that is converted into a substitute check. The term "check" under the Act is defined to mean a draft payable on demand and drawn on or payable through or at an office of a bank, whether or not negotiable, that is handled for forward collection or return, including a substitute check and a traveler's check. There are certain provisions in the Act, such as the expedited recredit procedures for bank customers and the customer education requirements, that only apply to consumers, but the

overall scope of the Act applies to all bank customers. Congress did not exclude any type of customers or accounts from the Act.

B7.

Q. Can state warrants be converted to substitute checks?

A. Many states and other municipalities pay their obligations with warrants. These documents are considered non-negotiable instruments. Even so those state warrants that come within the definition of “check” (see description above) may be converted into a substitute check under the Act. Since warrants vary from state to state, banks processing such warrants should consult with their legal counsel as appropriate to determine coverage of warrants under the Act.

B8.

Q. If today a customer gets their original paid checks back in their statement, can they refuse to accept substitute checks and demand the original paper checks?

A. No. The substitute check is the legal equivalent of the original check and neither the customer nor the customer’s bank can refuse to accept a substitute check because it is a substitute check and not the original check.

## **C Image Agreements**

C1.

Q. What kind of agreement is needed for image exchange?

A. Banks need an agreement to exchange images and to specify under what provisions those exchanges will occur. These agreements can be clearing house rules (e.g. ECCHO Rules), Federal Reserve Operating Circular or other bilateral/multilateral agreements among banks. Bilateral/multilateral agreements that are not under clearing house rules will bind only those parties that have made those agreements. Other parties that have an interest in the check that are not a party to the agreement are not bound by those rules. The normal collection and return of checks typically includes multiple parties such as the depositing customer, the depository bank, one or more intermediary collecting or returning banks, the paying bank and the drawing customer. There also is often one or more other non-bank intermediary endorsers. Agreements between the depository bank and paying bank outside of clearinghouse rules will bind only the two institutions and not all of the other interested parties.

C2.

Q. What provisions might be included in these agreements?

A. An exchange agreement might include but not be limited to the following: definition of when presentment would occur; identification of items eligible for

the exchange; timeframes for receipt of ECP (if banks will be exchanging electronic information about the checks in addition to the images); the timeframes for receipt of images and return items; assignment of liabilities among the parties; retrieval/request processes; retention requirements; image endorsement requirements; incorporation of other applicable law; and others provisions.

## **D Provisions of the Act**

D1.

Q. What are the warranties and indemnifications provided for in the Act?

A. Under the Act, the bank that creates the substitute check, called the Reconverting Bank, and any bank that subsequently transfers, presents, or returns a substitute check for consideration provides the warranties prescribed in the Act, and an indemnity. The two warranties in the Act are: 1) that the substitute check meets all requirements for legal equivalence (that is, the substitute check accurately represents the information from the front and back of the original check and includes the required legend identifying it as a legal copy of the original check), and 2) that no bank will be asked to make payment on an item that it has already paid (no double debit). The warranties travel with the substitute check and any subsequent image of a substitute check, and apply regardless of whether a subsequent party receives the substitute check or an image of the substitute check.

The indemnity is provided to all parties in the collection or return stream for a loss that occurred due to the receipt of a substitute check that would not have occurred with the original check. The indemnity also runs with the substitute check, but unlike the warranties the indemnity only applies to a person that has received the substitute check.

D2.

Q. Is there the potential for consequential damages under Check 21 and who would be responsible for those damages?

A. Yes. Any bank that provides a substitute check is potentially liable to an indemnified party for consequential damages when there is a breach of warranty.

D3.

Q. What other financial liability is incurred under the indemnity?

A. The indemnity amount for a non-breach of warranty is for the amount of the loss up to the amount of the check plus interest and expense.

D4.

Q. What is a substitute check under the Act?

- A. A substitute check means a paper reproduction of the original check that:
- Contains an image of the front and back of the original check
  - Bears a MICR line containing all the information appearing on the MICR line of the original check, except as provided under applicable industry standards
  - Conforms, in paper stock, dimension and otherwise, with generally applicable industry standards for substitute checks, and
  - Is suitable for automated processing in the same manner as the original check.

D5.

Q. How does a substitute check become the legal equivalent of the original check?

A. In addition to meeting the above criteria for substitute checks, the check must also accurately represent all of the information on the front and back of the original check as of the time the original check was truncated and must bear the legend: 'This is a legal copy of your check. You can use it the same way you would use the original check'.

D6.

Q. What is a reconverting bank under the Act?

A. A reconverting bank is the bank that creates the substitute check, or if a substitute check is created by a person other than a bank, the first bank that transfers or presents that substitute check.

D7.

Q. Are there any other reconverting bank responsibilities when creating substitute check under the Act?

A. Yes. The substitute check also must bear all the endorsements applied by any party previously handling the check, whether in electronic or paper form, for either a forward collection or return. The bank that created the substitute check, called the reconverting bank, also must be identified on the substitute check.

D8.

Q. Does a bank have to accept a substitute check?

A. Under the Act, any person or bank may deposit, present or send for collection or return a substitute check without an agreement with the recipient if the bank has made the warranties set forth in the Act. The warranties need not be affirmatively made, because they automatically attach through the act of transferring, presenting, or returning a substitute check for consideration.

D9.

Q. If a bank has to accept a substitute check, why is it said that the Act is voluntary?

A. While a bank has to accept a substitute check, the Act does not require any party to create substitute checks. Banks and their customers will make their own decisions based on their business considerations as to whether to create substitute checks.

D10.

Q. Is a bank required under the Act to destroy the original paper check, and if so when?

A. The Act puts no destruction requirements on the truncating bank. A bank truncating the original paper check should evaluate its business considerations including but not limited to risk, cost, etc. in determining how long, if any, the original paper check should be retained. In an image exchange where agreements are required, the agreement may provide for check retention requirements that a bank must fulfill. Considerations for these agreements could include various federal and state laws that may specify retention requirements.

D11.

Q. What happens if a substitute check is incorrectly charged to a customer's account?

A. The Act requires that the bank that transfers, presents or returns a substitute check and receives consideration for it provide two warranties and an indemnification to other parties in the payment stream. Under the Act, a customer or bank can have a warranty or indemnification claim against a bank making the warranties or indemnification. The Act also provides for an expedited recredit procedure for consumer customers that receive a substitute check. These procedures identify how long a consumer has to make a claim, the notification required by the banks, when and how much funds must be provided to the consumer, and other procedural requirements.

The Act's warranty provisions would apply only if the incorrect charge to the customer's account resulted from a breach of either of the two substitute check warranties prescribed in the Act. The indemnification and expedited recredit provisions of the Act would apply only if the incorrect charge resulted from receipt by the customer of the substitute check and would not have occurred had the customer received the original check. Regardless of whether the warranty, indemnification or expedited recredit provisions of the Act are applicable, the customer would have the rights provided under the Uniform Commercial Code and other check laws in connection with the unauthorized charge to the customer's account.

D12.

Q. Can a consumer make a claim for expedited recredit if they received an image statement with an image of a substitute check?

A. No. The expedited recredit procedures and indemnity only apply when the consumer actually received the substitute check. Image statements are

provided to customers under agreement between the customer and the bank, and errors will be resolved under that agreement. However, regardless of whether the expedited recredit or the indemnity applies, a claim for a breach of warranty may still apply, since the account was charged with a substitute check. Also, the consumer would have all of the rights provided under the Uniform Commercial Code, Regulation CC and other law.

D13.

Q. What customer education/notification is required by the Act?

A. The Act requires that banks provide a consumer awareness notice. A bank must provide to each consumer a notice that describes how a substitute check is the legal equivalent of an original check and a description of the consumer recredit rights as provided in the Act.

D14.

Q. To whom must the bank provide the customer education/notification?

A. The customer education notice is only required to be sent to consumer customers. The following consumer customers must receive the notice: a consumer customer who is a customer of the bank as of the effective date of the Act and who receive original checks or substitute checks; new consumer customers who will receive original checks or substitute checks at the time the relationship is initiated; and consumer customers when requesting a copy of a check and receiving a substitute check.

D15.

Q. Will there be any guidance on how this Act will be implemented?

A. Check 21 authorizes the Federal Reserve Board to adopt regulations to implement, prevent evasion of, facilitate compliance with the Act, and the Board is expected to adopt regulations prior to the effective date of the Act. Also, the Federal Reserve Board is required to publish a model form that a bank may use for the consumer awareness notice.

## **E. Substitute Checks**

E1.

Q. What is the difference between a substitute check and an IRD (Image Replacement Document)?

A. A substitute check is defined in the Act (see question above). An Image Replacement Document (IRD) is the name that the ANS X9.90 standard uses for the substitute check. An IRD by definition in the ANS X9.90 standard will always be a substitute check. Under both the Act and the ANS standard, a substitute check (and IRD) must contain an image of the front and back of the original paper check; must bear a MICR line containing all information from the original paper check (except as required by industry standards to facilitate

processing); must conform with other industry standards; and must be suitable for automated processing.

E2.

Q. Who is required to pay for the creation and transportation of the substitute check and how much is it expected to cost?

A. The Act does not indicate who pays for the creation and transportation of the substitute check. Under current check operating procedures the sending bank is responsible for the cost of collecting an item. So, absent an agreement to the contrary, the bank creating the substitute check (the reconverting bank) will pay for the creation and sending of the substitute check.

There is not sufficient experience with substitute checks to reasonably estimate the cost of creating and transporting substitute checks. These costs likely will be dependent on a variety of factors, including the number of substitute checks a bank creates and the technology the bank uses to create the substitute checks.

E3.

Q. Is it true that the substitute check will look different than the original check?

A. A substitute check in many ways is exactly like an original paper check, but there are some differences and improvements over an original check. The substitute check contains an image of the front and back of the original check and contains all of the endorsements that would have appeared on an original cancelled check. Some of the endorsements will be printed in a specific area on the substitute check making them clearer to read versus regular endorsements that are in many cases difficult to decipher. The substitute check will be printed on regular check paper stock. The differences that customers may notice is that the substitute check is approximately the size of a corporate check, the image of the original check on the substitute check has been reduced somewhat from the original size, and additional information appears on the front of the substitute check. This additional information includes information related to who truncated the original item, who converted this item into a substitute check, the legal legend as required by the Act, and optional control and security information. As required by the Act, the substitute check can be processed as the original check and is the legal equivalent of the original check.

E4.

Q. Does a substitute check require full MICR?

A. Under both the Act and the X9.90 standard, a substitute check must contain the complete MICR line as it appeared on the original check and the amount. Under the X9.90 standard, a special code in what is known as the EPC field or position 44 is required on all substitute checks. This identifies

that the item is a substitute check and that the image of the original check already has been reduced once for printing on the substitute check, and should not be reduced again. The digit aids subsequent parties in processing and potentially creating another substitute check from an image of a prior substitute check.

E5.

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

A. Yes, as long as the formatting of the second substitute check conforms to X9.90, banks can create a substitute check from an image of a prior substitute check. Creating a substitute check from a substitute check will require the bank to “clip” certain areas of the original substitute check to be placed on the subsequent substitute check.

E6.

Q. What are the special codes required in the EPC field (position 44) of the check?

A. Under the ANS X9.90 standard, for a forward substitute check a ‘4’ must be placed in position 44. For a return substitute check, a ‘5’ must be placed in position 44.

E7.

Q. How will a bank know how to create a substitute check that conforms to the requirements of the Act?

A. An ANS standard has been developed for substitute checks, known as X9.90 – Specifications for an Image Replacement Document (IRD). This standard describes exactly where on the substitute check all the required information must be placed. It can be obtained through X9 or ANSI.

E8.

Q. If the MICR line information on a substitute check must be repaired, are there any special considerations a bank should be aware of?

A. The Act does not expressly address the issue of MICR line repair. The Act does require the full MICR line from the original check to be on the substitute check, except as variations are permitted under industry standards. If a bank is responsible for the failure of a substitute check to include the full and correct MICR line information, subsequent recipients of the check may have a warranty claim against that bank, if as a result of that failure the substitute check is determined not to accurately represent all of the information on the front and back of the original check as of the time it was truncated.

E9.

Q. Are there any special considerations of which a bank should be aware when returning a substitute check?

A. Yes. Under the ANS X9.90 standard, if a bank is returning a substitute check and is creating a qualified return item, which usually requires the identification of that item with a '2' in position 44, it will now be required to use a '5' in position 44.

## **F Relationship to Other Law**

F1.

Q. How does Check 21 relate to the NACHA rules and Regulation E?

A. There is no direct relationship of Check 21 Act to NACHA rules and Regulation E. Check 21 Act is Federal law, but other than the special provisions for substitute checks under the Act a substitute check is governed under all applicable check law from beginning to end, and all rights and obligations of check law stays in place for substitute checks. This check law can include the UCC and the Federal Reserve's Regulation CC. Transfers initiated by check are excluded from Regulation E coverage.

F2.

Q. How does this Act relate to other law?

A. This Act supersedes any provision of Federal or State law that is inconsistent with the Act. A substitute check that is the legal equivalent of the original check is subject to any provision of check law as if it were the original check to the extent such provision of law is not inconsistent with the Act.

## **G Customer Service/Education**

G1.

Q. What educational opportunities are anticipated?

A. The Act requires banks to provide certain educational materials to their consumer customers who receive original checks or substitute checks. In addition, it is expected that there will be significant education of the banking industry as well as other pertinent industries. Seminar's workshops, conferences, implementation guides and consulting projects are just a few of the types of training and education expected.

G2.

Q. Will customers still be able to receive their cancelled checks?

A. Customers that still receive their paper checks with their bank statement will continue to receive cancelled checks with their bank statement, but some of these checks may be substitute checks. The Act provides that these substitute checks are the legal equivalent of the original checks for all

purposes, including state laws and customer agreements that require the return of cancelled checks.

G3.

Q. If a customer needs to obtain an original check that has been converted to a substitute check, how can the customer go about locating it and gaining access to it?

A. The Act does not require that an original check be retained or provided to the customer. Banks typically provide their customers with a copy of a paid check upon request. Under the Act, a bank is required to provide the original check or a copy of the original check in connection with expedited recredit claims by consumers. Other provisions of the Act recognize that the bank can provide either the original check or a copy of the original check. A copy of the original check could be a substitute check.

## **H Proof of Payment**

H1.

Q. What should be done if a business refuses to accept the substitute check from a customer as proof of payment?

A. While the Act does not require any notification or education to any party other than consumers, it may be helpful for banks to also educate their business customers as to the legal equivalency of the substitute check. Initially in situations like this, the bank may determine to help their customer explain to the business that the substitute check is the legal equivalent of the original check.

H2.

Q. Can businesses, courts, or governmental organizations refuse to accept substitute checks as proof of payment?

A. No. A substitute check that meets all the requirements of the Act (accurate image plus legend) is the legal equivalent of the original check and must be accepted as proof of payment.

H3.

Q. What remedies are available to check writers should businesses, courts, or governmental organizations refuse to accept the substitute check?

A. The Act does not specifically address remedies for this type of situation. A customer's remedies are the same as they are today when some entity refuses to accept a proof of payment. However, based on the newness of this program, the customer's bank may need to help in educating the entity that substitute checks are the legal equivalent to the original check.

## **I Security Features**

I1.

Q. If an original check had a security feature that did not survive when the substitute check was created and a loss occurred due to the lack of that feature who is liable?

A. Check 21 does not expressly address issues relating to security features on substitute checks. The aggrieved party may, depending on the facts and circumstances, have a claim under the Act's indemnity provisions against any indemnifying bank, because the loss arguably would not have occurred if the aggrieved party had received the original check instead of the substitute check. The loss of the security feature also may involve a warranty breach if it is determined that because of that lost security feature the substitute check did not accurately represent all of the information on the front and back of the original check as of the time it was truncated. It is anticipated that image and substitute check survivable security features will be developed to replace existing security features that will not survive to the substitute check.

I2.

Q. Are there security features that will be used in place of the physical ones that will be lost due to imaging?

A. The industry is working on a number of "image survivable" security features that will provide similar protections against loss that current paper check security features provide. For more information regarding some of these features refer to DSTU X9.90 Annex F.

## **J More Information**

J1.

Q. How do I get more information on improving the efficiency of the check payment system including Check 21, its processing and business implications, image exchange, image rules, reduction in bad check write-offs and membership in ECCHO?

A. Check out the ECCHO website at [www.eccho.org](http://www.eccho.org) or contact ECCHO directly at (214) 273-3200.