

Check 21 : An Opportunity Chain In Waiting

Print distributors who are selling negotiable documents to financial institutions and commercial accounts, no doubt, are beginning to field questions on the new Check 21 legislation and its implications to banks and their various account holders.

The legislation, which was passed unanimously by both the Senate and the House of Representatives, has been the source of much confusion, myth, and misinformation since the day it was signed into law by President Bush on October 28, 2003.

Although legislation of this type had been proposed as far back as 1987, the current law, The Check Clearing for the 21st Century Act, was a direct result of the terrorist attacks that rocked our nation on September 11, 2001. In the days that followed the attacks on the World Trade Center and the Pentagon, airline traffic across the country, including Federal Reserve aircraft, was grounded, bringing to a standstill the delivery of paper checks for processing between financial institutions.

As a result, seven days apart, on October 8 and October 15 of last year, the House and Senate, without objection, passed similar versions of Check 21 legislation and forwarded them to the President for his signature. The Check Clearing for the 21st Century Act is scheduled to become effective on October 28, 2004.

In elementary terms, Check 21, or the Check Truncation Act as it is sometimes called, simply encourages check truncation (the replacement of a paper check with a digital image) earlier in the processing cycle by removing the need to transport the original check from the bank of first deposit to the check processor, and from the check processor to the paying institution. In order to accomplish this, the law provides for a new negotiable document, a substitute check or Image Replacement Document (IRD), and gives it equal legal status of the original paper check, allowing the financial institution the option of either

storing or destroying the original document once it has been captured electronically.

Before the passage of Check 21, check truncation could still occur, but only when an agreement was in place between the banks involved. In the absence of an agreement, the original paper check still needed to be transported and presented for payment to the paying institution.

Under Check 21 however, banks will be allowed to create electronic images of checks and send the images, as opposed to the original paper document, to a check processor such as the Federal Reserve. The check processor, in turn, can present the electronic image to paying banks that have agreed to accept images, but will reconvert the images into substitute checks (IRDs) when the paying bank will not accept electronic images.

According to Check 21 guidelines, the substitute check will contain all of the information on both the front and back of the check, including the MICR line and all endorsements, and will also state that it is a legal copy of the original check.

In spite of misinformation to the contrary, although Check 21 requires paying banks to accept substitute checks presented for payment, it in no way requires financial institutions to accept checks in an electronic format or to create substitute checks.

What it does do is allow a financial institution that wants to truncate and electronically present checks for payment to do so whether or not the check-paying institution is equipped to accept digital check files.

According to banking industry analysts, in spite of its high implementation costs, estimated at around \$10 billion over the next three to five years, the benefits of Check 21 are numerous.

First, it will allow financial institutions to process

checks faster, theoretically within minutes, thus reducing account holder float. Secondly, it will reduce the dependence on the transportation networks needed to move checks, including the associated costs and potential disruptions. But most importantly, analysts say Check 21 will save financial institutions an estimated \$7 billion annually in check processing costs.

Not only will The Check Clearing for the 21st Century Act benefit financial institutions though, there is also a potential upside for producers and resellers of products and services used by those institutions.

Although the legislation does not require institutions to present and receive electronic images for payment, industry experts, none-the-less, predict the nation's top 25 banks will lead the charge towards check truncation and become fully image-enabled by 2006.

Logically, mid-sized banks, those with assets of \$5 billion and more, are expected to follow suit and become image-capable by 2008. Even half of the nation's small banks, with assets of \$100 million or less, are expected to embrace check truncation and become image-enabled by 2008.

And as banks, large and small, adopt check truncation, a whole new opportunity chain presents itself to distributors.

Check truncation and image capture opens up opportunities for the sale of a vast array of peripheral products including image statement envelopes, 3-hole drilled

DDA statements, ring binders to hold the statement and check image pages, and pre-printed indexes to separate them.

Consumable products, such as MICR toner cartridges for laser printers used to print substitute checks, will also provide a money-making opportunity for distributors.

And, as sure as night follows day, digital capture of internal documents will follow the implementation of check truncation, necessitating the total redesign of virtually every teller line and back room document being used by the institution.

Without question, Check 21 represents the most significant change in the way banks will do business since the adoption of magnetic ink character recognition (MICR) technology some 45 years ago. And as the change to MICR presented opportunities back then, the adoption of check truncation will present equal opportunities today.

The well-educated and alert distributor will be in position to seize those opportunities.