

Check 21: What does it mean to you?

I. Introduction

On October 28, 2004, the federal Check Clearing for the 21st Century Act went into effect. Check 21, as this act is known to legislators and practitioners, is designed to expedite the check clearing and banking system used in the United States. As a practical matter, Check 21 seeks to make the check clearing process faster and more efficient by mandating the acceptance by all banking institutions of electronic checks. By allowing banks to remove the paper check from circulation and replace such with an electronically produced and processed “substitute,” Congress has heeded the requests of banks and other credit institution by eliminating the need to manually send the actual paper checks along the entire route of banks that a check may take in order to clear.

Check 21 institutes the aforementioned by eliminating the need for banks to request permission of its customers to process checks electronically. Prior to Check 21, it was not uncommon for individual banks to seek such permission, but it could only be extended to the bank on which the particular customer’s check was drawn, and not every bank through which a check may pass through on the route taken to clear. By requiring banks to accept electronic substitutes and eliminating the customer permission requirement, Check 21 may ultimately save the banking system substantial time and money by virtue of getting rid of the need to store and transport millions of paper checks.

Should a customer or bank desire to keep receiving paper checks, Check 21 allows for the sending of the “substitute” checks. In order to satisfy Check 21's requirements, such substitute check must contain all information contained on the original check, in which case it will serve as a bona fide negotiable instrument and the legal equivalent of the original.

II. Immediate Impact and Future Expectations

The long term goals of Check 21 are lower check-processing costs and a more efficient banking system. Its immediate impact will be seen by banks’ customers in the form of faster clearing checks (both those written and accepted) and in the elimination of the age-old practice receiving actual cancelled checks along with their monthly statements. The expedited clearing process may, as a practical matter, present some difficulties as businesses and consumers become accustomed to the reduction in the “float” period between the writing or sending of a check and the time at which the check actually clears and is debited from the account.

Another effect of the act is the requirement that all retailers, service providers, courts, and other common recipients of negotiable instruments must accept the substitute checks as proof of payment of an invoice or other debt. Keep the following in mind:

1. A substitute check must include an accurate representation of all of the information on the front and back of the original check (Name, Address, Routing and Account Numbers, Endorsements, etc.).
2. A legend should appear stating: “This is a copy of your check. You can use it the same

way as you would the original check.”

3. Substitute checks can thus be accepted as proof of payment, but NEVER accept a substitute check as initial payment of an obligation.

The shortened time period for the clearing of checks under Check 21 can provide mixed results depending on your status. As a vendor or creditor, you will be able to ascertain whether a payment made by check has cleared in a much shorter amount of time. If your business writes more checks than it receives, or if it operates on a tighter cash-flow, however, you may find yourself reminiscing about the old “float” period for checks, and should pay closer attention to your account balances and outstanding payments. Likewise, strict oversight and reconciliation of your accounting records with your monthly statements will want to be observed so as to minimize the effects of a possible “double-debit” on your account. This could possibly arise in situations where both the original check and the substitute are processed, and although the act contains procedures for re-crediting accounts upon the submitting of a claim to the bank, it remains the duty of the customer to point out such an error should it slip through the bank’s safeguard procedures. The re-crediting provisions in the Act apply only to consumer-held accounts, however, and the provisions in the UCC Articles 3 and 4 would still govern procedures for improper debits to commercial accounts.

C. Conclusion

The reality is that Check 21 will not work to lessen or change the rights and obligations of an issuer or recipient of checks. Nonetheless, when dealing with negotiable instruments one should take the time to contemplate the implications of the Act, both the expected results and the possible concerns. At least for the foreseeable future, and especially as banks are in transition towards reaching full compliance, any endorser of checks should remain diligent in their account reconciliation and aware of the faster check-clearing mechanisms at work in the marketplace.

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