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# Check 21 White Paper

Intuit, Inc.

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## Summary

Through “The Check Clearing for the 21<sup>st</sup> Century Act”, better known as Check 21, the Federal Reserve and financial institutions<sup>1</sup> are modernizing the U.S. payments system - changing the way the checks are processed. The new federal legislation, which takes effect on October 28, 2004, allows financial institutions to create and present a substitute check for payment in place of the original check, accelerating settlement and eliminating many of the costs and risks of physically transporting checks. The changes increase the use of electronic data processing and move away from physically transporting the original check document from point to point throughout the clearing process. Primarily directed at the relationships between financial institutions and the check processing systems, the new law may have some impact on you.

Although Check 21 does not require you to change the way you accept and deposit checks, you may notice the changes in the following areas:

1. The “float” – the time between when a check is written and when it is debited from your account – will likely decrease as image exchange accelerates between banks.
2. You will no longer, as a matter of course, be able to receive your original cancelled checks from their financial institutions as a standard service.
3. Over the next several years, there may be fewer check formats and layouts that conform to the new check processing system.

For those who rely on Intuit’s software and check products to help them manage their personal and business financial activities, Intuit’s money-back guarantee that its checks will be accepted by every financial institution in the U.S. will continue to protect you.

## The Check Clearing System

A coordinated network of banks and financial institutions is necessary clear checks. From the moment a payor gives a check to a payee as payment until the amount of the check is credited to the payee’s account and debited from the payor’s account, many financial institutions may accept, process and forward the check. A series of state laws and agreements between financial institutions govern each transaction in the clearing process.

### ***Before Check 21***

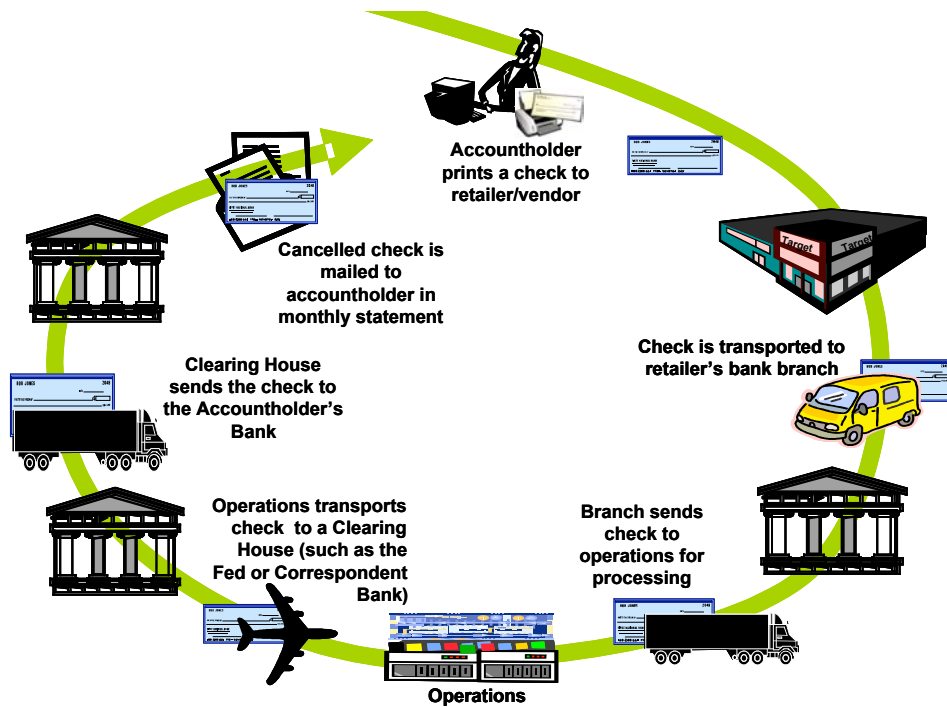
The check clearing system has relied on the ability of any bank in the processing chain to demand, and receive, the original check written by the payor before it processes the request for payment. A financial institution could examine the check and make its own determination of the validity and negotiability of the check before crediting or debiting an account.

Because the processing steps in the clearing system have always been tied to a financial institution’s possession of the physical check, the physical check had to be moved to each step in the clearing process. In completing the clearing process, each check has been returned to the check writer’s financial institution to be debited from his/her account. As a consequence, the financial institution had the ability to return the cancelled check to its customer subject to conditions set in the account agreement with the financial institution.

## Typical clearing process, Current

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<sup>1</sup> Financial Institutions: banks, credit unions, brokerage firms, insurance companies, investment companies, trust companies, lending institutions and thrift institutions.



Source: John H. Harland Company  
(Legends have been modified)

As economic activity increased and expanded beyond local boundaries, reliance on physical presentation of the original check created numerous delays and obstacles in the check processing system. Each day, airlines and other forms of mass transit transport millions of checks between banks and processing centers. Recently, some financial institutions have been making agreements between themselves to use and accept electronic images of checks for processing. However, because any financial institution in the processing chain had the right to reject the electronic information and require the original check for processing, the system still relied upon and must transport the original physical checks.

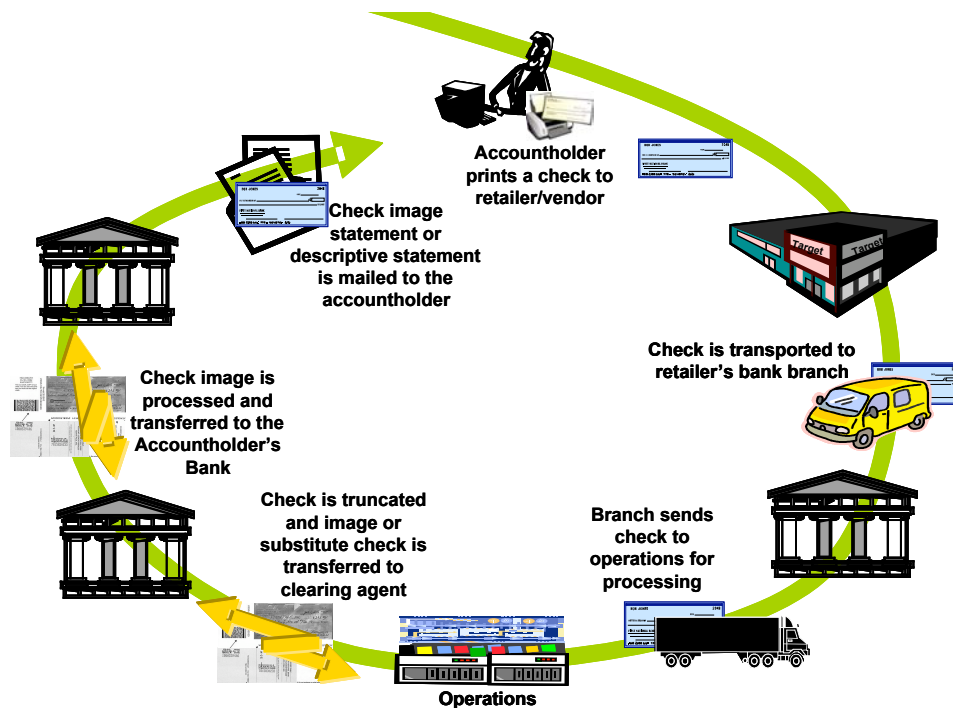
## **Check 21 - Introduction**

For several years, financial institutions have sought ways to make the check clearing process more efficient and less costly and cumbersome. In the days after the attacks of 9/11, the nation's air fleet was grounded and the check processing system came to a standstill. The risk of transporting millions of checks from point to point intensified efforts to develop more efficient ways to process checks.

In 2003, Congress passed "The Check Clearing for the 21<sup>st</sup> Century Act" to improve the overall efficiency of the payment system, to reduce the vulnerability of the financial system to interruptions in the transportation system and to shorten the time it takes to process a check. The law, known as "Check 21, makes it easier for banks to use electronic data processing by freeing them from reliance on the original paper check.

As checks are moved through the clearing system at the speed of electronic transmission rather than the speed of a van, train or airplane, the steps required to clear a check can for the vast majority of checks, be reduced and simplified resulting in less time required to process them.

## Typical Clearing Process, Post Check 21



Source: John H. Harland Company  
(Legends have been modified)

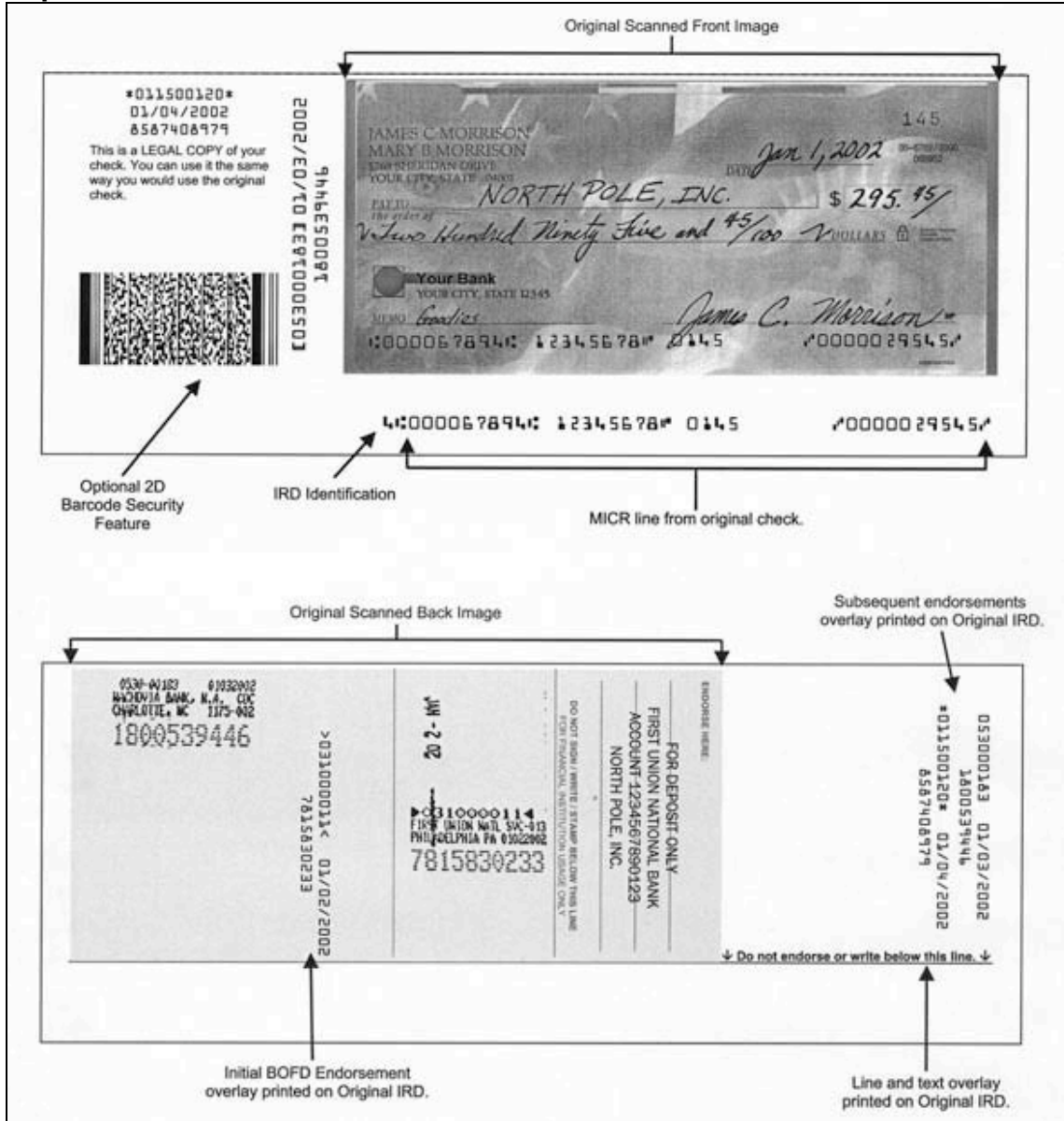
### **Check 21 - Substitute Checks**

Check 21 eliminates a financial institution's ability to insist on receiving the original check for presentment and processing. Instead, it creates a new instrument called a "substitute check" that can be created and printed from the electronic image of the original check to meet processing requirements of the financial institutions requiring paper and at the same time provide the legal equivalent of the original check. Check 21 requires all financial institutions to accept substitute checks in lieu of the original. As a result of this requirement, the original checks no longer need to be transported to each point of the clearing process.

The substitute check is a paper reproduction of the original check that contains an image of the front and back of the original check and meets the technical and legal requirements of the new law. A substitute check can be used by financial institutions, authorities, payees and payors in the same way as an original check.

A substitute check must be an accurate image of the original check at the time it converted into an electronic image. However, certain security features, such as watermarks and microprinting will likely not survive the image creation process. Similarly, some security features not apparent when examining the original check, such as faint mark "void" that is highlighted when photocopied, will be apparent on the substitute check. The lack or addition of these features when a substitute check is printed does not prevent it from being considered an accurate image of the original.

## Example of Substitute Check:



There are potential limitations to the substitute check images. Some types of check fraud, particularly forgery or alteration of the check after it has been written, are most easily detected by examining the original check. Subtle erasure marks or a difference in the pressure points in the signature can be the basis for detecting check fraud. These features will not necessarily be captured during the electronic imaging of the original check.

After Check 21 takes effect on October 28, 2004, when a financial institution or payor seeks to obtain the original check, the bank or institution in the clearing system that has most recently handled the electronic image of the check, can create and provide a substitute check from the image in lieu of producing the original check. Therefore, instead of transporting original checks to any potential party that demands to receive it; an image of the original check can be stored and transferred electronically, and printed out when and where it is needed.

## **Check 21 - Consumer/Payor Protections**

Check 21 protects against many of the risks associated with substitute checks by creating warranties that financial institutions must make when using a substitute check and establishing protections against inaccuracies in their use.

According to the "Check 21 Legislative Overview" produced by the Federal Reserve Financial Service, dated December 2003:

### **Existing Consumer Protections**

*Substitute checks will be subject to all of the consumer protections granted under existing check law:*

- *UCC Articles 3 and 4: A bank may only charge a properly payable check to a customer's account, and must resolve claims timely in order to limit liability*
- *Federal Reserve Board's Regulation CC*

### **Warranties and Indemnities Under Check 21**

*Check 21 also provides additional warranties and an indemnity protection. Under Check 21, a bank that transfers, presents or returns a substitute check would:*

- *Warrant that the substitute check meets legal equivalence requirements.*
- *Warrant that payment will not be requested based on a check that has already been presented (no double debit)*
- *Indemnify substitute check recipients for a loss that is due to the receipt of a substitute check instead of the original check.*

### **Expedited Recredit Provisions**

*Check 21 also includes expedited recredit provisions for consumers who suffer a loss because of a substitute check. A consumer may file a claim for expedited recredit within 40 days of receipt of the relevant statement or substitute check if certain conditions apply. Under the legislation, every bank must distribute to its customers an informational brochure, including descriptions of the substitute check process and consumer recredit rights.*

## **Check 21 and You**

The law will take effect on October 28, 2004, and the impact on individuals and small business will depend on the aggressiveness with which financial institutions and processing centers adopt the technological standards supported by the law.

We, at Intuit, have evaluated Check 21 and consulted with financial institutions, processing centers and other industry participants. Based on this research, we anticipate Check 21 may produce changes in the following three areas:

### **1. Check Writing**

- **Account Balances:** As the check processing system adopts the changes initiated by Check 21, the system will clear checks in less time. Paper check transactions that now take three or more days to process will clear the next day. This means:
  - Potentially faster access to money deposited in your account.
  - Reductions in float as the time to settle transactions between financial institutions decreases.

Currently, a check takes an average of one or two days to be debited to a writer's account once the check is presented. This time lag – the “float” – allows an account holder to keep money in their account for a number of days until the check they have written is processed and debited from their account. The processing of electronic images should substantially reduce the time required to clear a check and, therefore reduce the float available to an account holder.

The reduced float time may not be apparent to account holders immediately. However, as the processing system increases its speed, it will be more likely, for example, that a check written two days before payday will be debited from the account before the paycheck is deposited.

Reduction of float increases the need for all account holders to maintain up-to-date and accurate account information. Writing a check without knowing that the account balance will cover the amount of the check at the time it is written may result in an increase in returned checks and associated fees from financial institutions and check recipients.

- **Style of Check** – Over time check formats may become increasingly standardized to ensure that all checks conform to processing requirements and produce a high quality image. Previously, financial institutions have been able to process a wide range of check layouts, formats and styles. With the need to meet the Check 21 processing and imaging standards, banks may begin to limit check styles, formats, and fonts or may charge a fee for non-standard checks. For most people the changes will be minor. When new checks are printed, the margin area around the border of a check may be slightly larger than it is currently and the space in which the numeric amount of the check is written may shift to a specific position on all checks.

## ***2. Reconciling an Account – cancelled check return***

If you currently receive your cancelled checks with your account statements, you may receive a combination of both original checks and substitute checks with your statements. If you request check copies or view images online with your financial institutions, you also may start to see substitute checks or copies of substitute checks. As has been discussed previously, the substitute check is the legal equivalent of the original check and can be used for proof of payment.

## ***3. Receiving Payment by Check - Fraud***

As has been previously discussed, there are potential limitations to the substitute check images. Some types of check fraud, particularly forgery or alteration of the check after it has been written, are most easily detected by examining the original check. Subtle erasure marks or a difference in the pressure points in the signature can be the basis for detecting check fraud. These features will not necessarily be captured during the imaging of the original check. If a payor or payee suspects a check has been altered, they should contact their financial institution immediately and request the original of the check in question if it is available. Check 21 does not require automatic destruction of original and the financial institution may be able to locate the original and produce it for examination if they received it for processing.

The ability of a financial institution to locate an original check however should not be relied upon. For businesses and individuals receiving checks, it continues to be important to watch carefully for checks that have been altered or may have other signs of fraudulent use. For check

writers it is important to maintain accurate and up to date information regarding checks written and to reconcile the account often.

## **Intuit and Check 21**

When Check 21 takes effect and the check processing time is reduced, it will be more important than ever to maintain up to date and accurate account information. This information will allow you to ensure there is a sufficient balance in your account to cover any check you write. Additionally, having an accurate record of which checks you have written, to whom and for how much will be the foundation for detecting inappropriate activity, due either to fraud or inaccurate check processing, in your account. Intuit's financial management software, including QuickBooks®, Quicken®, MasterBuilder™, EasyACCT®, can easily assist you in accurate and timely record keeping.

The check processing system will likely increasingly rely on a standard set of processing/imaging requirements. As these standards are developed, Intuit will monitor the software and check products we supply to individuals and businesses. As always, it is important to keep your software up-to-date by downloading and installing software updates as they become available. Intuit will continue our money-back guarantee that Intuit's checks will be accepted by every financial institution in the U.S.

Our commitment to helping you manage your personal and business financial activity remains as solid as ever.

## **FAQs**

### **What is Check 21?**

The Check Clearing for the 21<sup>st</sup> Century Act (Check 21) was signed into law and is effective as of October 28, 2004. Check 21 is designed to increase the efficiency and security of the national check payment system by promoting the use of electronic image technology to reduce vulnerability to disruption and dependence on air/ground transportation.

The Act authorizes the creation of a new negotiable instrument called a "Substitute Check". Check 21 provides the legal framework for the creation of Substitute Checks; under this new law, financial institutions may present Substitute Checks in lieu of original checks to paying institutions.

### **Why haven't I heard about Check 21 before?**

The Check 21 Act takes effect on October 28, 2004, and the final version of the rules covering its implementation were released in July 2004. The law requires financial institutions to notify customers who currently receive their original checks of the Check 21 changes by the first regularly scheduled communication after the effective date, or when the bank presents a substitute check to an account holder, whichever is sooner.

### **Will I get back my cancelled checks with my statement?**

You will continue to receive the same description of payments you do now. If you do not receive your cancelled checks now, your monthly statement will be unaffected. If you currently receive your original checks, you may begin to notice a combination of original checks and paper representations of substitute checks.

**What is a Substitute Check?**

A Substitute Check is a paper reproduction of the original check. It must contain an image of the front and back of the original check, including all the pertinent information of the original check. Additionally, it must include the financial institution's endorsements (by the financial institution that converted the original check to a Substitute Check and all the financial institutions that received the Substitute Checks) and bear the legend that states: "This is a legal copy of your check. You can use it the same way you would use the original check."

**What do I do if I believe one of my checks has been altered? Won't I need the original check to prove my claim?**

The Check 21 Act provides account holders with specific recrediting rights. If you believe the substitute check does not accurately reflect the transaction, contact your financial institution immediately (you may be asked to submit your claim in writing).

**What if there is a dispute and someone won't accept the substitute check as proof of payment?**

The substitute check is the legal equivalent of the original. Courts, businesses, and service providers are all required to accept the substitute check as proof of payment in the same manner as they would accept the original.

**What types of checks does Check 21 cover?**

All checks drawn on U.S. financial institutions are eligible to become Substitute Checks. Examples include: Consumer/personal checks, Business checks, Corporate checks, Government warrants, U.S. Treasury checks, Money orders, Controlled disbursement checks, Payable through drafts, Traveler's checks.

## References, More Info, Links

Check 21 will take effect on October 28, 2004. Because it relies substantially on industry standards and practices, it will take some time for the full impact of the new law to become apparent. In the meantime, if you would like to learn more about Check 21, several sources are offered here:

**The Federal Reserve Board:**

<http://www.federalreserve.gov/paymentsystems/truncation/default.htm>

**"Check 21 Legislative Overview"** produced by the Federal Reserve Financial Service, dated December 2003: <http://www.frbervices.org/Retail/pdf/check21overview-FS.pdf>

**About Check 21:**

<http://www.frbervices.org/Retail/check21About.html>