

Check Clearing for the 21st Century Act A Brief Overview of "Check 21"

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A recent federal law, Check Clearing for the 21st Century Act ("Check 21"), 12 U.S.C. 5001, et seq., became effective on October 28th, 2004. This law is designed to enable financial institutions and banks to become more efficient by creating electronic images of the estimated 40 billion paper checks written annually, and promoting the exchange of these checks electronically. This, in turn, should result in a faster and more efficient check processing system. Prior to this law, most banks physically moved original paper checks from the depositing bank to the payor bank. This transportation can be inefficient and costly.

Instead of physically moving paper checks from one bank to another, Check 21 allows banks to process more checks electronically. Banks can capture a picture of the front and back of the check along with the associated payment information and transmit this information electronically. If a receiving bank or its customer requires a paper check, the bank can use the electronic picture and payment information to create a paper "substitute check." This process enables banks to reduce the cost of physically handling and transporting original paper checks, which can be very expensive.

However, Check 21 does not require banks to either refrain from sending or include actual checks in a customer's monthly, bank statement. The contents of an account statement are governed by the account agreement between the bank and its customer. Rather, when banks have agreed to provide paid checks in statements, Check 21 permits the bank to provide either the original check or a substitute check.

It has been widely noted that the speed of check-processing has increased due to Check 21. It is common for a deposited check to be delivered overnight to the paying bank and debited from the checkwriter's account by the next business day. Check-processing speeds should continue to increase, over time, as banks make further operational changes in response to Check 21.

Another federal check law, the Expedited Funds Availability Act, specifies the maximum times by which your bank must make funds available to you, though most banks make funds available faster than required. Check 21 did not change these maximum hold times. However, the Expedited Funds Availability Act requires the Federal Reserve Board to reduce maximum hold times in step with reductions in actual check-processing times. Thus, over the longer term, if Check 21 sufficiently increases the speed of check processing, the Federal Reserve Board should reduce maximum hold times as well.

IMPORTANT IMPLICATIONS FOR THE REAL ESTATE PROFESSIONAL:

1. Checks brought to a closing or disbursed from an escrow account may be presented for payment much faster than in the past, which will result in funds being withdrawn from the account sooner.
2. Banks may use a new negotiable instrument referred to as a “substitute check” to replace the original check. A substitute check is a paper reproduction of the original check and will be the legal equivalent of the original.
3. Some proponents of Check 21 argue that fraud can be detected earlier with the improved speed in check clearing
4. Other critics of Check 21 argue that it will be much more difficult to identify and prosecute criminal offenders for forgeries or altercations of checks, given that the original check will most likely be destroyed by the process created under Check 21.
5. It is highly recommended that all closing agents or escrow companies identify the policies and procedures of their bank, and either obtain canceled checks or substitute checks for their trust accounts.
6. Under the current statutory language of Check 21, banks are not required to create substitute checks to send to other banks electronically nor receive checks in electronic form from another bank.