**“Check Your Calendar:
The ‘Check 21 Act’ Takes Effect in October”**

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Introduction

On October 28, 2004, a new banking law takes effect that will significantly change the manner in which checks are processed nationwide. The Check Clearing Act for the 21st Century (Check 21 Act), H.R. 1474, Public Law 108-100, will allow any bank in the collecting chain to replace original paper checks with electronic images and, when needed in paper form, with a new negotiable instrument called a substitute check or Image Replacement Document (IRD).

The Check 21 Act was designed to encourage the use of technology to improve the efficiency of the check payment system. Check processing time will be greatly reduced by transmitting check images electronically among banks and the Federal Reserve. Physical checks need no longer be shipped from location to location. Processing costs should likewise be reduced, so customers will have access to their funds more quickly.

Check Replacement

The Check 21 Act permits banks to truncate original paper checks by replacing the original check with an electronic image or an IRD to be forwarded to the next bank in the check clearing process. The next bank in the chain is not required to accept an electronic image, and may require delivery of an IRD. The truncating bank may retain or destroy the original check.

Under the Check 21 Act, an IRD is the legal equivalent of the original paper check as long as it meets certain requirements. To be legally equivalent, the IRD must accurately represent all the information contained on the front and back of the check when the original check was truncated; conform to certain industry standards concerning the MICR line, stock, and size; and bear a legend indicating it is the legal equivalent of the original check.

The Check 21 Act does not specify how long the bank must maintain the original paper check or how it is to be destroyed. Some banks already provide Chapter 13 trustees with electronic images of the checks, but currently they also provide the original canceled checks pursuant to United States Trustee Program policy. The practical effect of the Check 21 Act is to remove the requirement that banks maintain the original canceled checks.

After the effective date of the Act, any entity or person that requires an original check must accept an IRD. The Act does not require banks to obtain agreements from all parties with an interest in the check prior to truncation. Chapter 13 trustees will not be able to influence the truncation decision, particularly because it may be made by a bank other than the one where the trustee’s account is housed.

The most immediate effect upon Chapter 13 trustees is that, as early as November 2004, your bank may stop sending you any original canceled checks or, in the alternative, may send you some combination of original canceled checks, electronic images, and IRDs.

In December 2003, the Federal Reserve Board issued a proposed rule to implement the Check 21 Act, and requested comments from interested parties. The proposed rule covered topics such as image quality for IRDs, return of unpaid electronic imaging and IRD checks, warranties and indemnities, and other clarifications. Comments were due to the Federal Reserve Board by March 12, 2004. Information about the Act and the proposed rule may be found at http://www.federalreserve.gov/paymentsys.htm under the heading "Check Clearing for the 21st Century Act." Comments on the proposed rule are posted at www.federalreserve.gov/generalinfo/foia/proposedRegs.cfm ; scroll down to "Regulation CC-Availability of Funds and Collection of Checks [R-1176]."

U.S. Trustee Program's Response to the Check 21 Act

Current Program policy requires Chapter 13 trustees' banks to provide original canceled checks to you with the monthly bank statement, which assists in the prompt detection of errors, forgeries, alterations, and unauthorized signatures. This policy will be revised to conform with the requirements of the Check 21 Act.

The Executive Office for U.S. Trustees and the Chapter 13 Liaison Committee have engaged in discussions regarding the effect of the Act. In addition, the Program has established a working group to assess the Act's impact upon the administration and oversight of bankruptcy cases. The working group is reviewing trustee handbooks, the U.S. Trustee Manual, and other Program policies and will recommend any revisions needed as a result of the Check 21 Act.

We anticipate that, as the Check 21 Act is implemented, a number of issues will arise that affect Chapter 13 trustees. For example, bank statements will need to be timely reviewed and reconciled. The banks will provide only a limited time for trustees to notify them of errors, forgeries, alterations, or unauthorized signatures. There are questions whether a check inadvertently could be paid out twice, if a bank truncates the check but retains the original. The protections offered by "positive pay" would prevent a second payment, but not all trustees use that system. There may be issues concerning the legibility of the electronic images provided by the bank. On occasion, trustees will need to request IRDs to resolve disputes. The Program will issue guidance as needed.

Conclusion

Based on the potential savings in infrastructure and check processing costs, it is anticipated that eventually most banks, especially the larger institutions, will truncate original paper checks and issue IRDs. Original paper checks that have been truncated may not be available by the time Chapter 13 trustees receive monthly bank statements. If questions arise, trustees must rely on electronic images or IRDs.

It is unclear whether financial institutions will have the technology in place to fully implement the Check 21 Act on the October 28 effective date. In the interim, depending on the bank that handles the check, Chapter 13 trustees may receive a combination of original paper checks, electronic check images pursuant to the trustee's agreement with the bank, and IRDs. The U.S. Trustee Program will continue to work with the Liaison Committee and trustees to foster an efficient and effective transition into the Check 21 electronic environment.