Check Clearing for the 21st Century

"At the Federal Reserve Bank of Philadelphia, we look forward to the opportunities and potential afforded by Check 21. We are working to help banks prepare so they can take full advantage of its benefits and pass them along to their own customers."

~ First Vice President Bill Stone

By facilitating the use of new technologies, Check 21 will improve the efficiency and reduce the cost of the nation's check collection system, while providing better services to bank customers. Banks will achieve this by simply replacing original checks with electronically created substitute checks, both of which contain identical payment information. These substitute checks are paper reproductions that are the legal equivalent of the original checks.

Our nation's check payments system has changed a great deal. Just half a century ago, millions of checks were sorted by hand every day. Then, in the 1960s, mechanical high-speed processing equipment emerged as the most high-tech means to read and sort checks.

But change is constant in the banking industry. What was once touted as the latest technology is considered both costly and labor-intensive in today's fast-paced world. With around 40 billion checks processed each year, the industry is constantly challenged to become faster and more efficient to keep pace with change.

Despite the fact that check payments in the United States likely peaked in the mid-1990s and have declined gradually since, they still represent approximately half of the nation's noncash payment transactions. Checks are still the most popular form of retail payments in the U.S. after cash. To stay ahead of the ever-changing industry curve, the Federal Reserve System approached the U.S. Congress in late 2001 with a proposal that promised to bring check payments into the 21st century.

The Check Clearing for the 21st Century Act, also known as Check 21, will take effect on October 28, 2004.

This legislation facilitates the use of new technology in check payments, allowing for a more efficient system of check collection and processing. Under Check 21, financial institutions will be able to create substitute checks, using digital images and electronic check information, which will allow them to collect and return checks more quickly.

Check 21 is part of the broader process of electronic check presentment (ECP), whereby checks are cleared based on information gathered electronically rather than from the actual paper checks. The process is technologically sophisticated, yet quite simple: digital images of checks are transmitted electronically from banks where the checks were deposited to the "paying bank" (the check writer's bank), central operations center, or other service provider. From there, banks can elect to accept checks forwarded for collection either in electronic form or in the form of a substitute check.

The original checks are truncated, or stopped, before reaching the paying bank. The substitute checks—not the images themselves—serve as the legal equivalent of the original check. For the most part, Check 21 will be transparent to the consumer. However, bank customers who currently receive cancelled checks

First Vice President William H. Stone, Jr. (front) looked over the new check processing machines with (left to right) Assistant Vice President Ronald R. Sheldon, Vice President Arun Jain, and Assistant Vice President John P. Kelly.

Check Out the Benefits of Check 21

More choices:
By taking advantage of electronic check presentment and return capabilities, banks can offer an alternative to today's paper-based system.

Increased efficiencies:
By reengineering their infrastructure with electronics, banks can expedite the collection or return of checks, streamline internal processes, reduce operating costs, and realize greater efficiencies.

Greater innovation:
By providing innovative new services, banks can broaden their deposit options or extend deposit cutoff hours.

back may begin to receive some substitute checks after Check 21 becomes effective. Over time, customers' monthly statements may include only copies of check images or may simply list each transaction.

To prepare for this bold initiative, the Federal Reserve is actively involved in a number of projects focused on analysis, design, and development to ensure the readiness of our operations and to achieve strategic alignment with the financial services industry. The Federal Reserve System recently standardized its check processing platforms nationwide. In addition, Reserve Banks around the country intend to introduce a broad array of new and improved products, services, and solutions, supporting Check 21 and offering customers more options than ever before.

When asked about the future of checks, First Vice President Bill Stone had this to say:

"This new infrastructure for checks will enhance our capabilities and leverage our strengths in the dynamic payments environment. At the Philadelphia Fed, we continue to embrace technology and innovation as we seek ways to enhance our services. These changes will pave the way for new methods of operation, improved efficiency, and cost reduction in the nation's check processing system. The bottom line is better services for bank customers. Most important, it will enable us to more quickly and effectively respond to our customers' needs, which remain, as always, our foremost priority."