

Testimony of

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on behalf of

American Bankers Association

Consumer Bankers Association

The Electronic Check Clearing House Organization

and

The Financial Services Roundtable

before the

Financial Services Subcommittee on

Financial Institutions and Consumer Credit

of the

U.S. House of Representatives

on

The Check Clearing for the 21<sup>st</sup> Century Act

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Chairman Bachus and Ranking Member Sanders, thank you for inviting me to appear before the Financial Institutions Subcommittee today on behalf of the American Bankers Association, the Consumer Bankers Association, the Electronic Check Clearing House Organization and The Financial Services Roundtable (collectively, the “Associations”).\* My name is Grant Cole. I am a Senior Vice President for Bank of America in the transaction processing division of Bank of America.

The Associations thank Representatives Hart, Ford, and Ferguson for introducing H.R. 1474, the Check Clearing for the 21<sup>st</sup> Century Act. While the Associations would like to see some improvements to the “Check 21” bill, we believe that this legislation will serve as an excellent basis for final “check modernization” legislation that will benefit consumers, businesses, financial institutions, and the economy as a whole.

### **Overview of the Industry and the Act**

Let me start by providing a brief overview of the existing check clearing process. Today, most paper checks are physically delivered between the institution that the check is deposited at, called the depository bank, and the institution the check is drawn on, called the paying bank. Oftentimes, a third party such as a private collecting bank that receives checks from one or more depository banks and sorts and handles the checks on their behalf before physically transporting each check to the paying bank on which it is drawn.

Obviously, this current check payment system relies heavily on an extensive network of physical check couriers, who transport the check from location to location. Additionally, this system has required extensive capital investment, where the Federal Reserve, depository institutions, and third party vendors run multiple processing facilities throughout the country. This system is remarkably efficient given the large

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\* Appendix I of this testimony further describes each of the organizations represented by this testimony.

volumes and reliance on physical transportation of paper documents. However, we are at a crossroads.

Let me explain. At Bank of America, we have approximately 27 million customers. For those customers, checks are second only to cash as the most popular choice for making payments. In fact, for all depository institution customers, the number of checks written exceeds all forms of electronic payments combined. However, Federal Reserve data indicates that the number of checks being written is falling, while the number of electronic payments is increasing. If this trend of decreasing check volumes continues, as is expected, it will dramatically change the cost structure of payments processing. Checks will likely soon become more expensive to process than other forms of payments such as credit or debit cards. To some extent we have already seen the effects as decreasing check volumes has resulted in the Federal Reserve choosing to close several check processing sites and cut back operations at others. Many private sector companies involved in check clearing are contemplating or have made similar changes. Passing check modernization legislation will create new efficiencies and help mitigate this effect. In fact, passing check modernization legislation as soon as practical is critical, if Congress is interested in protecting the check payments system and allowing those consumers that choose to write checks to continue to do so.

### **Benefits of Check Modernization Legislation to Consumers and Businesses**

We believe that check modernization legislation will benefit consumers and businesses in a variety of manners.

First, we believe that check modernization legislation will lead to streamlining the collection and return processes, thus providing a new value proposition for investments in check imaging technology. This will lead to consumer and business depositors having information about fraudulent and non-sufficient funds checks

sooner. As a result, depositors will be better positioned to collect from check writers, thus reducing the amount of losses that depositors experience from bad checks. At Bank of America and many other large and small financial institutions, customers can view check images just hours after the check enters our banking system. Fraud can be thwarted by allowing customers to examine check images once checks are received by the bank without having to wait until the end of month for the paper check to be returned to them in the mail. Additionally, employees in branches, call centers, and operations departments that are authorized to view check images can do so as well. These employees can use this technology to identify and combat fraud and help customers avoid losses as well.

I should point out the technology to provide check images to customers, and to exchange images between banks is highly secure. Institutions such as Bank of America and our image archive vendor use highly sophisticated firewalls and cryptography to deter hackers or other unauthorized persons from accessing customers confidential check information.

Check modernization legislation will also lead to even better customer service. The use of imaging has allowed depository institutions such as Bank of America to respond to customer inquires regarding checks in a much more timely manner because customer service personnel can oftentimes view check images immediately rather than having to wait while a researcher searches for the original paper check or finds a microfilm copy. By providing a new value proposition for imaging, check modernization legislation will make imaging more common, which will increase the reach of this consumer friendly technology.\*

Another consumer benefit that would come out of check modernization legislation is that financial institutions could offer consumer and business customers a broader

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\* Appendix II of this testimony includes quotations by real Bank of America customers extolling the benefits of check imaging.

variety of deposit options or extended deposit cutoff hours. For example, a greater number of remote ATMs could offer deposit taking because electronic processing is more economically feasible compared to having to physically pick up the checks at the ATMs. This would be particularly beneficial in rural areas where frequent collection of paper checks is quite difficult.

Let me make another point that, in my opinion, the industry has not effectively made. The point is simply this: check modernization legislation will help preserve customer payment options, or said another way, check modernization legislation will protect the check as a payment option for those customers who like to write checks. Earlier I indicated that checks are the second most popular payment option for Bank of America customers, and for financial institution customers as whole. Without check modernization legislation, consumers may increasingly find that they are being encouraged not to write checks, even if it would be their preferred payment choice. For example, it must be noted that the cost of check fraud has encouraged a number of businesses not to accept customer checks. In many circumstances, customers are being migrated away from checks to electronic payments such as so-called “Reg. E” conversions that provide customers with less information on their statements than they would with substitute checks. The decrease in fraud that will result from adoption of check modernization legislation may encourage businesses to accept checks as a form of payments. This benefits customers by increasing customer choice in payments.

### **Benefits to the National Economy**

In addition to the direct benefits that will accrue to consumers and businesses, check modernization legislation will benefit the economy as a whole. Perhaps the most important of these benefits is that passing check modernization legislation will reduce the dependence of the check payment system on physical transportation networks. Unexpected disruptions to the nation’s check transportation system will be better

avoided, whether natural disaster, bad weather, or terrorist attack cause the disruption. Bank of America, as well as other institutions, has had the unfortunate circumstance where bundles of checks that were deposited or drawn on our bank have been destroyed when a plane carrying our checks has crashed. Check modernization legislation, by taking physical transportation out of the check clearing equation, would create efficiencies and avoid delays and problems for customers that occur when the physical documents are unexpectedly destroyed.

Additionally, check modernization legislation will eventually lead to a lower cost payment system. By allowing financial institutions to redeploy resources currently devoted to the transportation, storage, and processing of paper checks, institutions will have more capital available to serve our customers.

### **Concerns with the Act as Introduced**

While the Associations support the concepts of H.R. 1474, I would be remiss if I did not point out several areas where we believe the bill could be improved.

First, the Associations believe that the special recredit rights included in Section 6 are not necessary because current check law already provides consumers with appropriate protections in the relatively few cases where consumers have check problems. Under the proposed Section 6, a customer's depository institution would be required under certain circumstances to recredit the account of the customer by up to \$2,500 by the end of the 10<sup>th</sup> business day following receipt of a customer's notice that a substitute check was not properly charged to the account. It is important to recognize that even if the recredit right included in Section 6 were to be removed from the Act, customers who receive substitute checks would continue to have all the rights and protections provided under Federal Reserve Regulation CC and the Uniform Commercial Code to the same extent as if the customer had been provided the original check. The UCC

imposes liability on depository institutions that charge a customer's account for a check that is not "properly payable."

The Associations are concerned that the recredit provision in Section 6 could open up their member institutions to fraud, where customers falsely make a claim, receive the recredit and withdraw the funds before the depository institution resolves the investigation. In the event that the Committee and the Congress leave the expedited recredit section in the bill, it could be improved by lowering the amount of the recredit from \$2,500 per check to \$1,500 per day. While most consumer checks are written for amounts well below \$1,500, persons intending to commit fraud will be well aware of the maximum recredit amount, which provides them the opportunity to earn greater returns for their fraud and create greater exposure for financial institutions.

Also, the Associations strongly encourage the Committee to change the definition of Substitute Check in Section 2, paragraph 17 of the bill. This definition, which has been changed from the definition in last year's bill, requires that a substitute check "...bears a MICR line containing all the information appearing on the MICR line of the original check..." This change could have the unintended effect of making it technologically unfeasible to process substitute checks, thus preventing institutions from being able to take advantage of the Act. The concern is that in order to be able to identify a substitute check from an original check, or one substitute check from another, the MICR line on the substitute check might have to be changed slightly from the MICR line on the original check. This is referred to in the industry as the "position 44" issue, because the industry plans to change the 44<sup>th</sup> position on the MICR line to indicate when a check has been truncated. The MICR line of certain returned substitute checks also will need to be slightly modified to appropriately identify the substitute check as a return item. If the entire MICR line from the substitute check has to be included on the original check, it might be impossible to distinguish originals from substitutes and thus impossible to process substitute

checks. Changing the definition back to the definition in the version of Check 21 introduced in the 107<sup>th</sup> Congress would solve this problem.

Another concern with the bill is the provision in Section 6(d)(3) that prohibits a bank from imposing overdraft fees with respect to checks drawn by a customer on a recredited amount on which availability is delayed as permitted by the bill for five day from the date the notice of the delay is provided to the customer. This provision creates significant regulatory burden and operational costs as depository institutions would need to create a process for determining when an overdraft resulted from delayed availability of the an expedited recredit. Many institutions' systems would have to be significantly altered to create an automated system for this to occur. A better approach would be to revise this provision to reflect the approach included in Section 229.16 of Regulation CC. That section of Regulation CC prohibits banks from assessing overdraft fees if the bank fails to provide a consumer with appropriate notice of delayed check availability. We believe that this is analogous to the issue of notice to consumers regarding the recredit.

Another suggestion would be to amend Section 11 of the bill, which requires customer education, to provide the Federal Reserve Board with the authority to waive the requirements of this section if the Board makes a finding that it is no longer necessary. While the Associations agree that the customer education notice is important to promote acceptance of substitute checks, there may come some time in the future where these checks are commonly recognized or no longer being used. At this time, it would make sense for the Board to have the authority to waive the customer education requirement.

One final suggestion would be to shorten the effective date of the bill from 18 months to one year. While the Associations applaud the change from last year's bill to 18 months, we believe that it is practical to have a more immediate effective date. Having an effective date that is too long will unnecessarily delay the Act's benefits to

consumers, businesses, and the entire economy. Further, because the bill is optional for truncating institutions, an earlier effective date will not force any institutions to begin imaging or truncating if they so not wish to do so. Because the substitute check will be able to be processed as a paper check and is the legal equivalent of the paper check under the Act, an early effective date will have little impact on paying banks and their customers. Also, one year should give the Federal Reserve sufficient time to promulgate the rules that they are authorized to issue under the Act. Additionally, the longer the delay in implementation, the more likely it will be that customers will be encouraged to move to alternate payments systems other than checks, reducing their payments choice and denying them the benefits of the Check 21 Act.

### **Concerns with Certain Proposed Changes**

I also would like to point out several areas where the Associations strongly disagree with suggestions for changes to the Act. The Associations do not support modifying the Check 21 Act so that certain classes of checks are not eligible to be truncated and turned into substitute checks (*i.e.*, a “carve-out”). From a technological standpoint, it would be very difficult for institutions to identify which checks are eligible to be truncated and which are not. Even if this could be accomplished however, including a “carve-out” for certain checks would severely undermine the benefits of the Act by requiring that institutions continue to maintain the physical infrastructure for processing and transporting originals while simultaneously operating electronic image exchange programs.

Likewise, the Associations strongly oppose expanding the scope of the Act to impose protections or requirements on check safekeeping, check truncation, check image or other check electrification programs that do not involve a substitute check. The special protections for substitute checks in the Act should only apply to situations where the customer actually receives a substitute check. The Act is designed to address a specific limited scenario - where the customer has not agreed to accept an

image or other electronic representation of the original paper check in lieu of the original paper check, and is being compelled by the Act to accept a substitute check. There is no justification for providing the new protections or requirements where the customer has agreed to accept images or some other electronic representation of the original check.

As evidenced by bank regulator and financial institution complaint records, the millions of customers today that have agreed to receive records of their check transactions via check image or check safekeeping programs are satisfied with this service. According to separate studies by financial services trade associations, approximately 30 percent of all checks written by commercial bank customers, literally billions of checks for millions of customers, are not returned to these customers in their monthly bank statements. The number of checks that are safekept would be even higher if credit union checks were included because credit unions, with a few limited exceptions, generally do not provide the original checks back to their member customers. The evidence is that these customers are experiencing virtually no problems when receiving images or other electronic representations of their checks instead of their original checks.

Expanding the scope of the Act to other arrangements not involving substitute checks would impose additional fraud loss and other costs on banks participating in these check electronification programs, thus discouraging bank participation in these programs, precisely the opposite result that the Act is intended to promote.

## **Conclusion**

Mr. Chairman, Ranking Member Sanders, thank you for inviting me to participate here today and allowing me to share my views, and the views of the American Bankers Association, the Consumer Bankers Association, the Electronic Check Clearing House Organization and The Financial Services Roundtable. Once again, I

applaud the work of Representatives Hart, Ford, and Ferguson, and we look forward to working with the Committee to enact this bill as soon as practical. I look forward to answering any questions that the Committee may have.

## **APPENDIX I**

### **American Bankers Association**

The American Bankers Association brings together all categories of banking institutions, including mutually-chartered savings banks and savings associations, to best represent the interests of the rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest banking trade association in the country.

### **Bank of America**

One of the world's leading financial services companies, Bank of America is committed to making banking work for customers and clients like it never has before. Through innovative technologies and the ingenuity of its people, Bank of America provides individuals, small businesses and commercial, corporate and institutional clients across the United States and around the world new and better ways to manage their financial lives. The company enables customers to do their banking and investing whenever, wherever and however they choose through the nation's largest financial services network, including approximately 4,400 domestic offices and 13,000 ATMs, as well as 30 international offices serving clients in more than 150 countries, and an Internet Web site that provides online banking access to 4 million active users, more than any other bank.

### **Consumer Bankers Association**

The Consumer Bankers Association is the recognized voice on retail banking issues in the nation's capital. Member institutions are the leaders in consumer finance (auto, home equity and education), electronic retail delivery systems, bank sales of investment products, small business services, and community development. CBA was founded in 1919 and provides leadership and representation on retail banking issues such as privacy, fair lending, and consumer protection legislation/regulation. CBA

members include 85% of the nation's largest 50 bank holding companies and hold two-thirds of the industry's total assets.

### **Electronic Check Clearing House Organization**

ECCHO is a not-for-profit nationwide bank clearing house that is 100 percent owned by its financial institution members. There are currently 19 member financial institutions of ECCHO, and these financial institutions hold approximately 60% of total U.S. bank deposits. Any depository financial institution, regardless of size, is eligible for membership in ECCHO.

ECCHO was created in 1990 by banks and other financial institutions to promote the electronification of the paper check collection process. Over the past twelve years, ECCHO has been deeply involved in almost every aspect of check electronification across a broad spectrum of banking institutions and organizations, regulators, service providers and check law initiatives. During 2001, ECCHO member institutions exchanged approximately 2 billion checks totaling approximately \$3.0 trillion under one of the ECCHO check electronification programs.

### **Financial Services Roundtable**

The mission of The Financial Services Roundtable is to unify the leadership of large integrated financial services companies in pursuit of three primary objectives: to be the premier forum in which leaders of the United States financial services industry determine and influence the most critical public policy issues that shape a vibrant, competitive marketplace and a growing national economy; to promote the interests of member companies in federal legislative, regulatory, and judicial forums; and to effectively communicate the benefits of competitive and integrated financial services to the American public.

## **APPENDIX II**

### **Comments by Bank of America Customers About Check Image Technology**

*Bank of America receives hundreds of unsolicited comments about our check imaging service. Here are a few samples of comments that we have received from real customers:*

“How great it is to be able to see the image of the check now on online banking? I just discovered it and will now stop receiving my checks in my statement. Thanks!”

“I just clicked on a check (that was posted on my internet statement) and it came up and showed me a copy of the check. **THAT IS THE COOLEST THING IN THE WORLD... IT IS THE TYPE OF THING THAT MAKES ME LOVE MY BANK.**”

“I think this is a really good thing to be able to view checks written. It makes it easier to know what it was made for in case there was every any fraud to detect.”

“Hello. I just wanted you to know I am so impressed with the service from Bank of America. I just did the “view check” and I feel this is a great service you are offering. I feel you have gone beyond the call of duty to you customers. Thank you.”

“Just wanted to let you know that I LOVE this feature of being able to look at the checks. Thank you so much for making my banking life so easy!!!”

“I was surprised and pleased to see my check image on my online statement. [With] this new process, I see no need to have my checks return[ed] each month... This is great.”

“OK, I know how these comment areas go. People use them to moan, moan, moan. Not this time. **THE VIEW OF THE CHEQUES IS AWESOME.**”

“Bank of America is the best (bank in the neighborhood and a-far). I needed a copy of a check and there it was. **THANKS.**”

“Dear Customer Service: I was surprised and pleased to see my check image on my online statement. If this is the new process, I see no need to have my checks returned each month. I can just print the ones I may need. This is great.”

“Availability of check images is a Godsend.”

“**WOW!** The new feature you added to view checks is totally awesome! Thanks for this new feature.”

“Having the image of the check to verify is a GREAT enhancement to the services [you provide]. CONGRATULATIONS on this one!”

“Hip! Hip! Hooray! What fantastic news!!! [Check imaging] is the greatest thing you have done in a long time! Thank you!!!”

“I never thought I would love a bank. But I love you guys. It seems that every time I log on the check my account, pay bills, or make a transfer you have made an improvement to an already wonderful site. This time it’s the feature that allows me to see checks and deposit slips. You don’t know how much I wish you’d teach other companies how to treat a customer.”

“I just wanted to let you know I’m THRILLED about the check image feature! I work for the back office of a bank, and every day I take requests for check copies for clients. It seems so inefficient and inconvenient to the client. I really appreciate this convenient feature.”

“I applaud Bank of America for making it so that a check can be viewed immediately, as opposed to having to order one which take over a week. Sometimes I forget to write down a check, and by being able to view it on the spot, I can balance my checkbook right then and there. Keep on making these wonderful enhancements.”

Thank you for now offering a scan of a written check. You make my online banking life wonderfully easy! I access this about once a day. When you have a business account, it is so important to be on top of the incoming and outgoing.”

“WAY COOL! Thanks for adding the function where I can view the front and back of my checks. WAY TO GO!”

“PRAISE!!!! I really like the new feature of viewing a copy of the actual check you write. I always forget who I write a check to. This is a wonderful feature...This has really helped my husband and I get our finance on track.”

“I absolutely love the fact that I can within seconds pull up copies of the FRONT and BACK of checks that have been cashed on my account! It makes life SO much easier! No hassles!”

“What AMAZING benefits!!! I am so pleased to see this new feature of viewing your check—it’s great! ...I am pleased to do business with you!”

“This is outstanding – no more of “what was that check for” – a real value added enhancement.”

“I really like the check imaging on the screen. It will be easier to get a canceled copy and proof that I paid. Thank you.”