

Testimony of
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On behalf of the
American Bankers Association
Before the
Subcommittee on Financial Institutions and Consumer Credit
Of the
Committee on Financial Services
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Good morning, Mr. Chairman, members of the Subcommittee. My name is Betsy Duke and I am the Executive Vice President of Wachovia Bank and the American Bankers Association (ABA)'s current Chairman. I am pleased to be here this morning to discuss the Check Clearing for the 21st Century Act ("Check 21"), the statute intended to promote the efficiency of check processing by allowing depository institutions to take advantage of 21st century technology. Under Check 21, no longer must checks physically travel across the country in order to be processed. Instead, the establishment of the substitute check has provided a vehicle to facilitate electronic check processing. While the transition to electronic check processing is a gradual one, we believe that ultimately, it will be beneficial to banks and their customers.

Testifying here today presents the banking industry with the opportunity to assure the Committee that, for the most part, Check 21 has meant business as usual for the average consumer. As expected, Check 21 means gradual and orderly change, for consumers and banks. Today's hearing also gives us the opportunity to correct much of the disturbing and continuing misinformation and inaccuracies promoted by some.

The American Bankers Association, on behalf of the more than two million men and women who work in the nation's banks, brings together all categories of banking institutions to best represent the interests of this 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.

We would like to emphasize a few points:

- As the ABA and the banking industry predicted, Check 21 was not a "flip of the switch" event, in part, because moving to electronic check processing is voluntary. Most consumers have yet to notice an impact. At

this time, it is expected that electronic check processing will not reach a significant level until late 2006 or early 2007.

- Contrary to press reports and statements by some consumer activists, federal law does indeed require that the time banks may hold deposits be shortened once the check processing system is, in fact, more efficient.
- The funds availability schedules should not be shortened until checks are actually processed more quickly. Most banks already make funds from most deposits available earlier than the law requires.
- Holds are critically necessary to help prevent check fraud, which harms both the banking system and consumers. It makes no sense to shorten holds before checks are actually processed more quickly.

As expected, Check 21 is an evolution, not a revolution.

Despite dire warnings by some consumer activists and reporters, that as of October 28, 2004, all checks would be processed “within hours,” Check 21 has basically been a nonevent for consumers. The move toward electronic check processing, facilitated by Check 21, is proving to be a gradual one. In fact, it is even slower than anticipated.

At Wachovia, we are considered to be a leading edge electronic check-processing bank, as we currently possess the ability to both send and receive electronic check images and data. However, despite these capabilities, we do not anticipate that we will be processing more than 2 to 3 percent of our checks via image exchange by years end. Furthermore, given our understanding of the time and investment required to implement electronic check processes, we feel that the industry ramp-up period will most likely occur somewhat slowly over several years.

More specifically to Check 21 and our responsibilities relative to the substitute check, Wachovia has gone to great lengths to ensure that all of our check-writing and depositing customers are appropriately notified of their rights under the Act. We are also actively monitoring all Check 21 related feedback received at our branches and call centers, and though some of our customers did share some concerns prior to the implementation date, we have logged very few customer comments or concerns in the past several months. One of the primary indicators of consumer impact from Check 21 is the number of expedited recredit claims we receive. If you'll recall, the expedited recredit provision provides recourse in the event of injury sustained due to the fact the consumer received a substitute check as opposed to the original. Of the roughly 2 million substitute checks that we have processed since the inception of Check 21, we have received zero expedited recredit requests.

According to the Federal Reserve Board ("Board"), less than one percent of the checks the Reserve Banks collect on a daily basis are either deposited with the Reserve Banks as image cash letters or truncated at the Federal Reserve Banks and converted into image cash letters using its Check 21 products. It has indicated that the average amount of a converted check is between \$13,000 and \$15,000, far above the average check of \$1,070 (includes both consumer and business checks).

ABA members also report that the migration to Check 21-type processing has been slow. Many are not yet converting their deposits into electronically transmittable images.

Some of the reasons that movement toward electronic processing is not more rapid are: 1) banks must invest in and deploy new systems; 2) some banks have adopted a wait and see approach; and 3) the current costs of creating a substitute check are often higher than the cost to process the check by the usual paper route.

It is also important to keep in mind that even in those cases where there is electronic processing of check images, at some point in the process, a substitute check is frequently created. This substitute check is then processed as any paper check, and it must physically travel. There are few transactions that are processed entirely by electronic means from the bank of first deposit to the paying bank. For example, many corporate customers are interested in converting their deposits into images to transmit to their bank electronically because they avoid expensive transportation costs. However, once the images reach the bank, they are converted into substitute checks for processing in the traditional fashion. This means that even though some checks are converted into electronic images and transmitted electronically for some portion of the check processing route, the checks are not necessarily being processed more quickly.

We expect that as systems are installed and the electronic process becomes more affordable, more banks will adopt electronic processing. At this point, it is expected that there will not be significant electronic processing of checks until late 2006 or early 2007.

Because the transition to electronic check processing has been gradual, the grim predictions that on October 28, 2004, the effective date of Check 21, consumers would be shocked that checks would be charged to their account instantaneously, generating "a barrage of bounced checks flying through the system,"¹ simply did not materialize. These erroneous reports, unfortunately, only served to alarm consumers unnecessarily.

¹ Suze Orman, "How the New Check 21 Law Affects You."
[Http://biz.yahoo.com/pfg/e21check/](http://biz.yahoo.com/pfg/e21check/)

As the check processing system becomes more efficient, the law requires that the funds availability schedules be reduced to allow consumers quicker access to their deposits.

Another alarming and persistent Check 21 myth is that Check 21 eliminates float for banks, but no law requires banks to make funds available sooner or pay interest sooner. This assertion is simply not accurate.

First, it is important to point out that most banks today already provide funds sooner than the law requires. ABA's 2004 *Deposit Account Fraud Survey Report* shows that most banks provide funds on the *day of deposit or the day after deposit*. For local checks, depending on the region, between 72 percent and 87 percent of banks provide funds before the law requires. For nonlocal checks, between 72 percent and 82 percent do so. These statistics are consistent with ABA's previous biennial surveys, conducted since 1992 (except one year when the Board conducted its own check processing survey). It is also worth noting that survey responses are based on the institutions' *published* funds availability schedule and indicate the *latest* funds will generally be available. In many cases, funds are made available even earlier. Moreover, any theoretical concerns about holds are exaggerated because the vast majority of consumers receive their most important check -- their paycheck -- by direct deposit. In this case, funds are available on the morning of payday.

Second, even when holds are placed, customers receive interest on interest-bearing accounts from the time the bank receives the funds. Check 21 has no impact on the long-standing requirement under Section 606 of the Expedited Funds Availability Act that depository institutions pay interest to consumers no later than the time the institution receives credit for the funds.

Third, federal law does indeed require that funds availability schedules be shortened once "most" checks are returned in a shorter time,² a fact that some consumer activists and reporters have ignored. Some have asserted that *Check 21* does not require the funds to be available sooner, which is technically correct, but quite misleading. Check 21 does not include such a provision, because the Expedited Funds Availability Act already does.

Congress recognized the existing requirement of the Expedited Funds Availability Act and therefore did not include a redundant requirement in Check 21 that would have created confusion and unnecessary debate. Moreover, the Expedited Funds Availability Act requirement was well understood and explained in Board discussions with industry and consumer representatives.

² Section 603(d) of the Expedited Funds Availability Act, 12 USC 4002(d), requires that the Board "reduce the time periods" to periods which allow banks to learn of nonpayment of "most items of each category of check."

In fact, pursuant to its responsibilities under the Expedited Funds Availability Act, the Board in December 1999 investigated whether the schedules should be shortened. After an expensive study, it concluded that checks were not being processed quickly enough to justify shortening the schedules. Since that study, until passage of Check 21, little had changed in check processing to suggest that checks are moving more quickly. We certainly believe that the Board, having previously demonstrated its commitment to comply with the statute, will continue to take its responsibility seriously.

The funds availability schedules should not be shortened until the check processing system is, in fact, more efficient.

The funds availability schedules should not be shortened until checks are, in fact, processed more quickly. Until that time, it is critical that banks have the option and flexibility to place holds pursuant to the Expedited Funds Availability Act. In brief, the system should allow time for the bank to learn that a deposit is not good before it must release funds. We realize that under the Expedited Funds Availability Act not all checks will be returned within this time frame, but at the very least, most should be.

To explain, today check processing typically requires that checks be physically transported from the bank of first deposit, by plane and truck, to the paying bank. If the check is returned because it is not payable, for example because it is fraudulent or there are insufficient funds in the account, it must make a return journey to the bank of first deposit. The journeys back and forth involve a complicated and sophisticated network of connections and transportation systems. Weather and other complications can slow delivery. The fact that it can take days for an unpayable check to travel from the bank of deposit, to the paying bank, and then back to the bank of first deposit is the reason holds are necessary.

Criminals attempt to take advantage of these check processing limitations and funds availability schedules by depositing fraudulent items and withdrawing the funds before uncollectible items are returned. They rely on the fact that banks, by law, must release funds before they can learn that the check is not payable.

Indeed, one particular scam in recent years that has fleeced thousands of consumers and banks relies on the requirement that banks release funds before the check can be returned. Under these scams, instigators of the fraud persuade consumers to accept a check, often a cashiers' check, as payment, and then ask the consumers to wire funds back to them (fraudsters) as soon as the funds from the check are available. While details vary and continue to evolve, in a common scam, the consumer is selling an item on the internet. The "buyers" (fraudsters) explain that because they are not in the United States, payment is difficult. They offer to have a "friend" in the United States, who owes them money, send the

seller a cashier's check in an amount greater than the purchase amount. The fraudsters then instruct the seller to wire the excess funds as soon as the bank makes the funds available.

Under the Expedited Funds Availability Act, the bank must make the funds available on the day after deposit and inform the consumer of this fact if asked. Accordingly, the consumer wires the funds as soon as funds are available, only to learn a few days later that the check is counterfeit. Consumers are then liable for those wired funds, as they authorized the transactions, but banks often suffer the loss because the consumer simply does not have the money.³

Fraudulent cashiers' checks are growing in frequency. Hardly a day goes by without the FDIC sending out a notice of fraudulent or stolen cashiers' checks.

As demonstrated, holds are important protections against fraud. In 2003, banks lost nearly \$700 million to check fraud.⁴ Consumer activists' calls to shorten the funds availability schedule before the system is actually more efficient are putting the cart before the horse. It would be irresponsible to remove these important fraud protection tools unless the system has otherwise addressed the threat.

To determine whether the system is more efficient, the Board is currently developing a study to determine how quickly checks are being processed. However, it is important to keep in mind that if a study were conducted today, the check processing times would probably not justify shortening the schedules. ABA's 2004 *Deposit Account Fraud Survey Report* found that most checks are not returned before the bank must release funds. The vast majority of *local* uncollectible checks are not returned to the bank of deposit until some time after the second day after deposit, when the funds must generally be available. Depending on bank size, less than half of uncollectible *nonlocal* checks are returned before funds must be available, generally the fifth day after deposit. Check 21 has yet to make a significant impact on these return times. Thus, if a study were conducted today, the funds availability schedules would probably remain unchanged.

It is also important to understand that studies to measure the speed of check processing are difficult and expensive. They should be done periodically, but not continuously, as has been suggested. Such in-depth studies require special efforts by bankers to carefully analyze, measure, and track check processing

³ ABA has partnered with the National Consumer League in efforts to warn consumers of these schemes. We jointly developed a pamphlet explaining the scams, available at the teller window or with statements. In addition, we participated in a radio tour of 18 stations, with an estimated 7.9 million listeners. A "matte piece" article was distributed to 10,000 outlets. Information is also available on our aba.com website.

⁴ *The ABA Deposit Account Fraud Survey Report 2004.*

times for items that have thousands of possible routes and endpoints. Asking banks to repeatedly divert resources to measure what has changed marginally provides little incentive to continue responding to multiple surveys. The result will be fewer and less robust responses that will diminish the value of any subsequent surveys. Accordingly, we strongly recommend that Congress give both the Expedited Funds Availability Act and Check 21 time to work.

ABA, as in the past, will encourage banks to respond to the Board's survey. When the Board conducted its last study, ABA refrained from conducting our own Check Fraud Survey so that banks could focus on and respond to the Board study. ABA will similarly encourage bankers to respond to the next study.

Concerns related to float are grossly exaggerated.

Adding to the concern and confusion about the impact of Check 21 were repeated assertions that consumers would lose float as of October 28, 2004 and suddenly and inadvertently be bouncing millions of checks. Some consumer activists asserted that consumers would bounce more than 7 million checks each month. Melody Hobson, a guest of Diane Sawyer on ABA's *Good Morning America*, echoed those predictions. Obviously, nothing like that has happened, nor do we expect it to. Nevertheless, those grim warnings continue to sound.

As discussed earlier, Check 21 will bring about gradual change. Consumers will not be caught unaware. As checks gradually are processed more quickly, those who use float will adjust their behavior as they have in the past. For example, before the introduction of magnetic ink character recognition (MICR), in the 1950s, checks were processed manually, creating a fairly lengthy float. As banks moved to processing checks in an automated fashion using machines that read the numbers found on the bottom of the check, float was drastically reduced. Consumers modified their behavior accordingly. We believe that consumers will again respond just as rationally and calmly as checks are over time processed more quickly because of Check 21.

Moreover, even if a consumer is caught off guard when the first check is processed more quickly than expected, most banks already waive overdraft fees for customers who occasionally overdraw their accounts if requested. Once consumers realize that checks may be processed more quickly, they will not continue to rely on the float and incur multiple fees, as some consumer activists have suggested. Consumers are smarter than that. They will adjust their behavior, much as people do not continue to park in illegal parking spaces day after day after receiving multiple parking tickets.

We should also point out that banks too will lose float; the money drawn on their customers' accounts will be withdrawn more quickly. Moreover, any float banks may derive from holds is wildly exaggerated. As noted, most banks allow customers to withdraw funds by the day after deposit, they pay interest from the

date they receive credit, and the permissible holds eventually will be shortened as the process becomes more efficient.

Images have been accepted as proof of payment for decades: a substitute check is unnecessary.

In addition to misperceptions about float and bounced checks, consumer activists have asserted that consumers need a “substitute check” for proof of payment, that an image of a check is insufficient for these purposes. Yet, for decades, the IRS, landlords, merchants, and others have accepted copies and images of checks as proof of payment. Virtually all credit union members and over 60 percent of consumers receive check images or copies and rely on them to prove payment. To assert that these images, which consumers have used for years, can no longer show proof of payment, is irresponsible and causes unnecessary concern and angst among consumers.⁵

Consumers are protected against unauthorized transactions even if they do not receive back a substitute check.

Concerns were also raised about consumer protections from unauthorized transactions when consumers receive back the original check or an image, rather than a “substitute check” with their statement. Check 21 kept existing state consumer protection laws intact and they need not be altered. State check laws (such as those based on the Uniform Commercial Code), which remain in effect, work. While the technical, legal details may vary, consumers, by law, generally are not responsible for unauthorized transactions, whether they receive back an original check, a substitute check, or a copy of either. Different laws use different terms, but whether it is called a recredit, a refund, or stated in some other fashion, the results are the same: generally, the consumer gets back the money in a timely fashion. Assertions to the contrary do a disservice to consumers who might be led to believe that they lack rights and, consequently, do not know to exercise them.

Moreover, in addition to legal considerations, customer service pressures ensure that banks resolve check disputes expeditiously. Banks have a good track record for investigating and resolving complaints in a timely fashion.

ABA has gone to great lengths to educate its members and the public about what to expect under Check 21.

Soon after passage of Check 21, we provided complimentary “Check 21 Toolboxes” to all our members. These toolboxes explain the new law and how to educate customers and the media about what to expect under Check 21. In

⁵ Even the Federal Trade Commission issued the misleading statement, since corrected, “You can use a substitute check as proof of payment, but only if it includes this statement: ‘This is a legal copy of your check. You can use it the same way you would use the original check.’”

addition, we provided to depository institutions an educational brochure, "Checks Are Changing," which many depository institutions have voluntarily provided to customers in addition to the statutorily required notice. ABA also participated in a Check 21 radio tour and distributed a video news release to all the television news departments in the country. We sent a sample personal finance column explaining Check 21 to 20,000 print publications. ABA responded to hundreds of inquiries from reporters and agreed to appear in numerous television news programs. ABA also provided a Check 21 media kit to all Congressional press secretaries. ABA staff even talked to and wrote letters to individual concerned consumers.

In addition to the industry's efforts, Congress ensured that consumers would be informed about Check 21 and its potential implications. It included in Check 21 a provision requiring that banks send out to affected customers explanations about Check 21 and its potential impact. ABA will continue these education efforts as Check 21 continues to be implemented.

Conclusion

Mr. Chairman, members of the Committee, I am pleased to have had the opportunity to report on the progress of Check 21 to date and to clear up some misconceptions about certain aspects of this law. I am happy to answer any questions.