STATEMENT OF

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ON THE

"CHECK CLEARING FOR THE 21^{ST} CENTURY ACT"

BEFORE THE FINANCIAL SERVICES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

U.S. HOUSE OF REPRESENTATIVES

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Chairman Bachus, Ranking Member Waters and Members of the Subcommittee, thank you for providing me the opportunity to appear on this panel today on behalf of the National Credit Union Administration (NCUA). NCUA is pleased to provide your Subcommittee with testimony concerning the subject addressed by H.R. 5414, the "Check Clearing for the 21st Century Act." My testimony will summarize credit union success with check truncation over the last 20 years.

NCUA is an independent federal agency that supervises and insures approximately 6,000 federal credit unions and insures approximately 3,300 state-chartered credit unions throughout the United States and its territories. NCUA appreciates the opportunity to share with the Subcommittee the credit union industry's experience with check truncation.

History

As you know, credit unions are cooperative non-profit financial institutions organized to provide individuals associated by a common bond with a place to save and a source of loans at reasonable rates. Although similar to other financial institutions, credit unions did not have the authority to offer share draft accounts – or checking accounts – until the mid-1970's.

In August 1974, NCUA adopted a rule authorizing federal credit unions to request permission to participate in pilot programs relating to electronic funds transfers

(EFT), loan programs, and other operational programs, including share draft programs.

The pilot program for share drafts was successful and NCUA adopted a final rule in December 1977, which provided guidance for offering share draft accounts and required truncation. The final rule defined "truncation" as when the original share draft, or check, is not returned to the credit union member. As part of any federal credit union's share draft program, a federal credit union was required to designate a "payable through bank" and truncate all of its members' share drafts. The rule also required a federal credit union to notify the agency whenever it modified its truncation procedures.

At the time, NCUA believed truncation was a significant development in the clearing process that contributed to reducing the overall cost of processing share drafts. NCUA believed that failing to require check truncation could weaken progress in this area and retard the development of EFT systems.

In 1980, after Congress expressly authorized all federally insured credit unions to offer share draft accounts,[1] NCUA proposed to integrate the share draft rule into the agency's rule on share accounts as part of its attempt at deregulation. That proposal retained the mandatory requirement to truncate share drafts, and updated the definition of "truncation."

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[1] Consumer Checking Account Equity Act (Public Law 96-221).

In proposing the rule, the NCUA Board considered the truncation procedure essential to maintaining the momentum of what it believed was an innovative practice. The Board also noted that truncation reduced the total cost necessary to operate share draft programs, which ultimately benefited credit union members. The proposed rule also removed the requirement that a federal credit union designate a payable through bank, so that a share draft could be truncated at any point in the clearing process. Although many comments received by the agency opposed mandatory truncation, NCUA adopted the final rule with the truncation provision in November 1980. The Board believed national policy, consumer benefits, and the fact that truncation had been required and had not shown any disadvantages, supported the Board's decision to retain the truncation requirement in the final rule.

In December 1981, the NCUA Board solicited comments on amending the rule on share accounts. After receiving many comments requesting that NCUA remove the requirement that share drafts be truncated, the Board agreed and issued a final rule in April 1982 that removed all operational constraints on share draft programs. Consequently, since that time, truncation has been a matter of choice and preference of credit union members.

Today, approximately 42.5 billion checks are written in the United States each year, and credit unions account for approximately 4.7 billion of those. Each day, these instruments are processed by the institution where they are deposited and then delivered for presentment to paying institutions throughout the country. Unlike banks and other financial institutions, most credit unions have used "truncated" drafts since they began offering these types of accounts to their members.

Sixty-four percent of credit unions currently offer share draft accounts and 91% of those credit unions utilize truncation. Approximately 7.1% of credit unions offering share draft accounts offer images of all checks with their statements.[2]

Process

In the credit union context, truncation generally occurs after the paper instrument passes through the clearing process and is returned to the paying credit union. In most cases, credit union members do not receive their checks back with their account statements. Instead, they receive a statement itemizing each draft. When needed, a member may request a copy of the draft from its credit union.

Currently, credit unions must enter into agreements with other financial institutions to present checks electronically.

Consumer Concerns

NCUA has not heard of an instance where a credit union member has experienced unusual hardship due to truncation.

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[2] Statistics from Credit Union National Association.

In response to a request made by the Federal Reserve in 2001, NCUA polled all six of its regional offices about consumer complaints received on share draft truncation. The results indicated only one complaint regarding truncation and it concerned the fees a member had to pay in order to obtain a cancelled draft. We are aware of only one other complaint related to truncation that was received after that polling of the regions and it, too, concerned the fees associated with obtaining a copy of a cancelled draft.

While fees are always an issue for consumers – and should be – a more efficient payment system should reduce the monthly cost of maintaining a share draft or a checking account. Savings passed onto consumers in monthly maintenance fees should far outweigh the occasional fee required to obtain copies of truncated checks when necessary.

Conclusion

At the time NCUA adopted the mandatory truncation rule, it was an innovative and cost-efficient improvement to traditional processing methods. The proposed legislation should improve the overall efficiency of the nation's payments system and guide the financial services sector to the next generation of cost-efficient check payments systems. NCUA, as demonstrated by its earlier rulemaking actions, supports measures that lower the costs for financial services for credit union members.

Thank you, Mr. Chairman, for allowing us a chance to highlight how check truncation works for credit unions. We commend you, the Subcommittee, and Committee for convening this meeting on this very important issue. I would be pleased to attempt to answer any questions you or members of the Subcommittee may have.