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H.R. 5414—THE CHECK CLEARING FOR THE 21ST CENTURY ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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H.R. 5414, THE CHECK CLEARING FOR THE 21ST CENTURY ACT

Wednesday, September 25, 2002

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to call, at 10:12 a.m., in Room 2128, Rayburn House Office Building, Hon. Michael Oxley [chairman of the full committee] presiding.

Present: Representatives Royce, Lucas of Oklahoma, Kelly, Gillmor, Grucci, Ferguson, Tiberi, Waters, Watt, Bentsen, Sherman, Moore, Ford, Hinojosa, Lucas of Kentucky and Inslee.

The CHAIRMAN. [Presiding.] The committee will come to order.

The chair would like to announce that the reason that Chairman Bachus is not here is that his 85-year-old mother had fallen and broken her hip this morning and he is now en route to Alabama to be with her. Obviously, all of us on the committee wish Chairman Bachus' mother a speedy recovery. I will begin the hearing and stay as long as I can, and then Ms. Kelly will assume the chair.

I want to begin by thanking Chairman Bachus for arranging this important hearing on the bipartisan legislation introduced by the gentleman from New Jersey, Mr. Ferguson and the gentleman from Tennessee, Mr. Ford. I would also like to thank the panel of witnesses who have come to testify before the subcommittee and give their insights into the need for this legislation. In particular, I want to welcome Mr. Lee Schram of NCR, based in my home state of Ohio in Dayton, and Mr. Joe Biggerstaff of AirNet Systems, based in Columbus, Ohio. I am looking forward to your thoughts and comments. I want to particularly thank Chairman Bachus for having two Ohioans testify before his committee.

When I became chairman of the Financial Services Committee, one of my primary goals was to ensure that U.S. financial institutions have the tools to operate in the most efficient manner possible, while maintaining the safety and soundness of the financial system. I believe we must implement the technological advances made in the field of payment systems to provide customers with expedited access to capital and credit, while ensuring that they are protected from fraud. The Check 21 legislation clearly achieves that goal.

Additionally, significant cost savings to customers and financial institutions will be realized with increased electronic check pre-

sentment. Too often we are hamstrung in our efforts to provide U.S. businesses and customers with access to the most effective means of dealing with one another.

There is another important reason why this legislation is needed. The terror attacks of last year forced us to reexamine how our country operates under adverse circumstances. This committee has been at the forefront of the efforts to ensure the integrity of our capital markets, to protect the U.S. money supply, to provide insurance against terror attacks, and with Mr. Ferguson's proposal and Mr. Ford's proposal, to safeguard the U.S. payment system against interruptions in transportation services.

So I anticipate we will hear from several of the witnesses. The days following September 11, 2002, placed the U.S. payments system in crisis when the flights that normally transported checks between banks across the country were grounded. With the enactment of Check 21, the need for the physical transportation of checks between financial institutions will be reduced, and any threat to the transportation system will not affect the presentment of checks in the payment system.

Finally, I would like to thank the Federal Reserve for its hard work in helping develop H.R. 5414 in consultation with this committee and other interested parties. I am hopeful we can achieve broad bipartisan support to move this proposal early in the next session. I am looking forward to the discussion on this legislation on future innovations in the U.S. payments system.

I now yield to the gentlelady from California, the ranking member of the subcommittee.

[The prepared statement of Hon. Michael G. Oxley can be found on page 40 in the appendix.]

Ms. WATERS. Thank you very much, Mr. Chairman.

We are here today to discuss the Check Clearing for the 21st Century Act. This legislation considers the transformation of our nation's payment system from a physical one to an electronic one. I have heard many arguments for and against this legislation, but my concern today is to ensure that we have a balanced bill that also focuses on issues that are vital to consumers. I am not opposed to the principle of having an efficient payment system in our country which would reduce significantly the check clearing time and provide substantial savings to the federal government and financial institutions as it relates to the transportation of physical checks. If this process requires elimination of paper checks, then so be it. Personally, I do not receive my checks back from my bank and that is by choice. This legislation should be about choice. It is my understanding that this legislation will eliminate the ability of millions of U.S. customers to get their checks back. There are currently 45.8 million households who enjoy receiving their checks back with their bank statements. This legislation will force them to change their practices. I do not support the fact that consumers have to give up their rights to receive their checks back. These 45.8 million American households should have the choice to say no to substitute checks.

Another concern I have is the issue of recredit. For example, if a check is paid twice or for the wrong amount, it is my understanding that this legislation does not grant the consumer an auto-

matic right to a recredit of the disputed funds. In fact, consumers whose accounts are governed by a voluntary check truncation agreement will not receive the right of recredit. Instead, they will have to wait months to get their funds returned since there is no limit on how long the bank can take to resolve a dispute about a check. My question is, what are the additional levels of protection a consumer has that proponents of this legislation are talking about? Does this proposed legislation cover this?

The issue of privacy is also a big concern of mine. There is a great deal of personal information conveyed on the face of a check, such as the name, address, telephone number and the Social Security of the issuer as well as the payee's name. When this information is captured and stored in a shared database through electronic imaging, banks can determine the consumer's check spending habits. Information about the consumer's religious, political and lifestyle affiliations can be revealed easily. Will this legislation take the invasion of a consumer's privacy under consideration?

What about the issue of availability? If customers accounts are going to be debited faster, will the funds be made available to them faster. Is the legislation taking this into consideration?

Having brought up the aforementioned issues to light, I look forward to the testimonies of the distinguished witnesses on the panel today and I hope to find answers to my questions.

I yield back the balance of my time, and I thank you.

The CHAIRMAN. The gentlelady yields back. Are there further opening statements?

The gentlelady from New Jersey—well close enough..

Mrs. KELLY. New York.

The CHAIRMAN. Yes.

[Laughter.]

Mrs. KELLY. We do not consider it close enough. We like the state as it is.

Thank you, Mr. Chairman.

Last week, the gentleman from New Jersey, Mr. Ferguson, and the gentleman from Tennessee, Mr. Ford, introduced H.R. 5414, Check Clearing for the 21st Century Act, or Check 21. This builds on a legislative proposal that the Federal Reserve submitted to Congress last December. We are very pleased to have the Federal Reserve represented here by Mr. Ferguson, as well as the distinguished group of other public and private sector witnesses.

Characterized by innovation, efficiency and speed, our nation's payment system has no equal in the world. And yet one of the many hard lessons that we learned in the aftermath of September 11 terrorist attacks is that this system is not without vulnerabilities. With planes grounded and the nation's air traffic system at a standstill, the check collection process which relies heavily on air and ground transportation to move checks around the country experienced serious disruptions. Since one of the terrorists' stated goals is crippling the U.S. economy, it is clearly in our national security interest to take those steps reasonably necessary to insulate the payment system from the effects of future terrorist attacks that target our financial centers and other critical infrastructures.

While there has been a marked decline in the use of paper checks in recent years, as consumers rely more heavily on credit and debit cards and ATMs and other forms of electronic payments, Americans still write more than 40 billion checks annually, according to the Federal Reserve estimates. In processing this huge volume of paper checks, banks and credit unions are already realizing significant benefits for themselves and their customers through the use of electronic presentment and check imaging technology. H.R. 5414 will help speed those innovations in the marketplace by removing legal impediments to electronic check processing, thereby promoting greater efficiency in the overall payment system and reducing the system's current reliance on the nation's transportation grid.

Consumers will benefit from a more electronic banking environment. Already, many institutions are deploying new technology to offer their customers enhanced products and services, including access to images of checks they have written on secure web sites and even ATMs. The Federal Reserve has identified other potential consumer benefits from the proposed changes to the payments system, such as broader deposit options and more timely account information and faster check collection and return.

Since receiving the Federal Reserve's check truncation proposal last December, the committee has engaged in extensive outreach to all interested parties including regulators, the banking and credit union industries, and consumer groups. H.R. 5414 is the product of all these consultations. While it does not reflect perfect consensus on all issues, the legislation is an excellent first step toward the creation of a payment system for the 21st century.

Let me again commend Mr. Ferguson and Mr. Ford for their collaboration on this important work. Thank you. I yield back my time to the chairman, the gentleman from West Virginia—or close enough.

[Laughter.]

The CHAIRMAN. All right. Touche.

[Laughter.]

Are there further opening statements? The gentleman from New Jersey, the author of said legislation.

Mr. FERGUSON. The gentlelady from New York and the gentleman from Ohio are both welcome in New Jersey anytime they would like.

[Laughter.]

Mr. Chairman, I want to thank you and Mr. Bachus for scheduling this important hearing on legislation that will help modernize the nation's check payment system and bring paper checks into the electronic age. As you know, current law requires banks to physically present and return original checks. This is a tedious and antiquated process that is inefficient, expensive and it is rife with potential for fraud. Today, millions of paper checks are physically transported between banks every day—a system that has historically relied on the steady flow of air and ground traffic in order to ensure that checks are presented to paying banks in a timely manner.

When the horrific events of September 11 halted all air traffic in the United States, hundreds of millions of checks did not move and

the U.S. payments system was stalled. This created a situation that severely threatened our economic security. As a result, the Federal Reserve after consulting with the banking industry and technology companies and consumer groups, submitted a proposal to Congress that would reduce the need for physical transportation of checks through increased electronic truncation. Since the Fed's proposal, this committee has been actively engaged in a dialogue with many interested parties, many of whom are represented here today.

Last week, Congressman Ford and I introduced the Check Clearing for the 21st Century Act, or Check 21, which builds on the Federal Reserve's proposal to modernize the nation's check payment system by allowing banks to exchange checks electronically. The legislation strengthens our economic security by capitalizing on existing technology to make the collection process faster and more efficient, while improving customer service, access to funds, and antifraud protections. By reducing the dependence of the check payment system on transportation networks, Check 21 will help to avoid negative economic impacts from unexpected disruptions to the outdated transportation system, whether caused by weather, natural disaster, terrorist attack or any other type of crisis. It will help to provide the framework for new financial infrastructure that is stronger, smarter and allows financial institutions to better serve consumers with quality, efficient products and services at greater cost savings.

I am pleased with the constructive feedback that we have already received from many of our witnesses here today and others, as well as the interest and support that my colleagues that expressed on this issue. While I believe that the Check 21 legislation is a sound product that reflects a multitude of views, I recognize that there is much work that needs to be done before we move toward a final product. I look forward to hearing the testimony and certainly welcome our witnesses and appreciate the testimony that they will be sharing with us here today on this important issue.

I yield back.

The CHAIRMAN. The gentleman yields back. The chair would indicate unanimous consent for any member to submit an opening statement for the record. Without objection, so ordered.

The chair would note that there are a series of votes—three votes on the floor of the House. What I would like to do is get started with the witnesses and then we will suspend and return. Let me introduce our first panel, the Honorable Roger W. Ferguson, Jr., vice chairman of the Board of Governors at the Federal Reserve. Mr. Ferguson, welcome back to the panel. Our second witness on this panel, Mr. Robert M. Fenner, general counsel of the National Credit Union Administration. I think this is your first appearance before the committee, is it not?

Mr. FENNER. In some years.

The CHAIRMAN. In some years. Okay.

[Laughter.]

Well, it is good to have both of you here and we appreciate your participation in this hearing. Mr. Ferguson, we will go with you first.

STATEMENT OF HON. ROGER W. FERGUSON, JR., VICE CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Mr. FERGUSON. I would like to thank the subcommittee for inviting me to discuss H.R. 5414, the proposed Check Clearing for the 21st Century Act. Since many of the members have already referred to the work of the Federal Reserve system, I would like to also do something which is frankly unprecedented, and acknowledge the strong work of three of the staff members who are here with me today—Stephanie Martin, Louise Roseman and Jack Walton.

This bill, which is similar to a proposal the board sent to Congress late last year, will remove existing legal barriers to the use of new technology in check processing, and holds the promise of a more efficient check collection system. The board commends Representative Ferguson and Representative Ford for introducing this bill.

Check processing is far more efficient than it once was. Less than 50 years ago, clerks hand-sorted millions of checks each day. In the 1960s, the banking industry began to use mechanical high-speed check processing equipment to read and sort checks. Today, banks, thrifts and credit unions, which I will collectively refer to as banks, process, as you have already noted, more than 40 billion checks that consumers, businesses and the government write each year.

Legal impediments, however, have prevented the banking industry from fully using new electronic technologies such as digital imaging, to improve check processing efficiency and provide improved services to customers. This is because existing law requires that the original paper checks be presented for payment unless the banks involved agree otherwise. During each step of the check collection process, the check must be physically shipped to its destination by air or ground transportation from the branch or ATM of deposit to the bank's operations center and often through one or more intermediaries before being delivered to the bank on which it was drawn. Of course, banks can agree to accept checks electronically, but the large number of banks in the United States makes it unfeasible for any one bank to obtain such agreements from all other banks, or even a large proportion of them.

Therefore, legal changes are needed to facilitate the use of technologies that could improve check processing efficiency, which should lead to substantial reductions in transportation and other check processing costs. H.R. 5414 makes such changes. The proposed Check Clearing for the 21st Century Act solves a longstanding dilemma—how to foster check truncation earlier in the check collection or return process, without mandating that banks accept checks in electronic form. The Act facilitates check truncation by creating a new negotiable instrument called a substitute check which would permit banks to truncate the original checks, to process the check information electronically and to deliver substitute checks to banks that want to continue receiving paper checks.

A substitute check, which would be the legal equivalent of the original check, would include all the information contained on the original check—that is, an image of the front and back of the check, as well as the machine-readable numbers that appear on the

bottom of the check. Under this Act, while a bank could no longer demand to receive the original check, it could still demand to receive a paper check. Because substitute checks could be processed just like original checks, a bank would not need to invest in any new technology or otherwise change its current check processing operations.

This change would permit banks to stop transporting original checks and would enable the banking industry to reduce its reliance on physical transportation, thereby reducing the risk that checks may be delayed in transit, for example, due to inclement weather. The banking industry's extensive reliance on air transportation was underscored in the aftermath of the September 11 tragedy, when air transportation came to a standstill and the flow of checks slowed dramatically. During the week of the attacks, the Federal Reserve banks' daily check flow ballooned to more than $47 billion, which is more than 100 times its normal level. Had the proposed legislation been in effect at that time, banks may have been able to collect many more checks by transmitting electronic check information across the country and presenting substitute checks to paying banks.

The Act might also better position banks to provide new and improved services to their customers. For example, banks might allow some corporate customers to transmit their deposits electronically. Further, if banks begin to transmit check images from the point of deposit to their operations centers for processing, they may be able to establish branches or ATMs in more remote locations and provide later deposit cut-off hours to their customers. Because the Act will likely encourage greater investments in image technology, banks might also be able to expand their customers' access to enhanced account information and check images through the Internet. In addition, banks might be able to resolve customer inquiries more easily and quickly than today by accessing check images.

We recognize that the most challenging policy issues in the proposed law and the aspect of this legislation that has generated the most spirited discussion relates to customer protections. Current check law protects customers if there is an unauthorized debit to their accounts. A customer already has a claim against its bank for an unauthorized charge, and the bank may be liable for interest on the amount of the unauthorized charge and consequential damages for the wrongful dishonor of any subsequently presented check.

The proposed legislation applies these existing check protections to substitute checks. There are, however, differing views as to whether additional customer protections are necessary for substitute checks and if so, how extensive those protections should be. We believe that in determining the form these protections should take, the associated benefits and costs will need to be carefully balanced. There are some technical matters in the current version of the bill that could be improved or clarified and we look forward to working with the committee as it further considers this legislation.

In conclusion, although an increasing number of payments are being made electronically, it is clear that checks will continue to play an important role in the nation's payments system for the foreseeable future. We believe that over the long run, the concepts embodied in the proposed Check Clearing for the 21st Century Act

will spur the use of new technologies to improve the efficiency of the nation's check collection system and provide better services to bank customers.

It is important to recognize three fundamental facts. First, the proposed Act merely replaces one piece of paper, the check, with another piece of paper, the substitute check, both of which contain exactly the same information front and back. Secondly, the proposed legislation lightens the regulatory burden on banks. And the third benefit is that it removes barriers to progress in this important area of payment systems. Because the Act should also result in substantial cost savings, it would also be desirable to begin obtaining these savings in the near future, ideally before the bill's proposed 2006 effective date.

Thank you for your time, and I would be happy to answer your questions.

[The prepared statement of Roger W. Ferguson Jr. can be found on page 62 in the appendix.]

The CHAIRMAN. Thank you, Mr. Ferguson. It is the intention of the chair to recess the committee to go over to the floor and vote, and then we will begin with Mr. Fenner when we return. The committee stands in recess for probably 20 minutes.

[Recess.]

The CHAIRMAN. The committee will reconvene. Before recognizing Mr. Fenner, the chair would ask unanimous consent that the imaging exhibit that Mr. Ferguson referred to in his testimony be made part of the record so that the members can actually get a look at the process. Without objection, so ordered.

We now turn to the aforementioned Mr. Fenner. Mr. Fenner, I am sorry for that delay, but you are now recognized for your testimony.

STATEMENT OF ROBERT M. FENNER, GENERAL COUNSEL, NATIONAL CREDIT UNION ADMINISTRATION

Mr. FENNER. Thank you, Chairman Oxley and members of the subcommittee. I am pleased to be here to report on NCUA's experience with truncation of sharedrafts in the credit union system. From 1974 when NCUA first authorized sharedraft accounts, which are the credit union version of checking accounts, until 1982, NCUA regulations actually required truncation. Truncation was an integral part of the early proposals that were developed in the credit union system for sharedraft programs, and NCUA believed that requiring truncation would foster the development of a more efficient system of checking accounts for credit unions and their members.

In practical terms, what truncation in credit unions meant then and what it means now is that when a member writes a check on the member's account at the credit union, the draft or the check proceeds all the way through the clearing process to the point where it is truncated or held by either the credit union or its corporate credit union or other processor. At that point, the information on the draft is stored electronically and printed on the member's monthly statement. In some cases, electronic images of the draft are returned with the statement, but that is not required.

When a member requests production of the original draft or a copy, the issue of fees is determined by agreement between the credit union and the member, and also issues of liability in the case of fraud or improper debiting or the like are determined under the Uniform Commercial Code and other relevant law. Since 1982, NCUA has not required truncation, but rather our regulations now leave that decision to the individual credit unions. Nonetheless, today 20 years later, 91 percent of all credit unions that offer sharedraft accounts do utilize truncation. We believe that that is the best evidence that truncation has been both a cost-effective innovation and one that is well accepted by credit union members.

Moreover, our evidence suggests that truncation has not been a frequent source of credit union member complaint. Surveys of our regional offices over the last two years have revealed no unusual hardships to credit union members, and only two instances of complaints made to NCUA. Both of those complaints related to fees associated with obtaining the original or a copy of a canceled draft, and that is an issue that we believe should be determined in the marketplace, and not by government regulation.

In closing, considering our positive experience with truncation, we are pleased to support the initiatives being considered by the subcommittee that would facilitate truncation at a much earlier stage in the collection process than the practices that exist in credit unions today, and also allow truncation of the check return process. We believe this legislation would clearly facilitate broader use of truncation and in our view it would improve the efficiencies of the payment system.

Thank you.

[The prepared statement of Robert M. Fenner can be found on page 55 in the appendix.]

The CHAIRMAN. Thank you, Mr. Fenner.

Let me begin the questioning with Mr. Ferguson. In the Fed's initial proposal, Treasury checks were exempted from being electronically truncated. Can you explain to the subcommittee why this provision was included in the initial draft? Assuming that there will be universal security precautions, shouldn't we be able to assume the safety of both federal checks and of private checks?

Mr. FERGUSON. That is obviously a very good question. You are right to note that in the draft that had been originally sent up from the Board, an exemption for the Treasury was included. That was included explicitly after some discussion with the Treasury. I do note that in H.R. 5414, there is no such exemption. From my personal point of view, and I think others who have thought about this would share this perspective, if the government through the course of the Congress and then through legislation signed by the president, believes that this approach as put forward in H.R. 5414 is a proper approach, then I would think it is quite reasonable for representatives of the Treasury to come forward to Congress and explain why it is that one set of checks issued by the government should be exempt from a procedure when we are allowing it for others.

The other thing to recognize is, as I have said before, this is really a question in which there are options being presented. Truncation is not being mandated. I do not think we should have the de-

bate about truncation, so much as about whether or not one piece of paper should be allowed to substitute for another. But to answer your question again on the Treasury, I think it is appropriate since it is not included in the Act, for them to simply come forward and explain their rationale. That seems to me a perfectly reasonable place to start this discussion.

The CHAIRMAN. We appreciate the Fed's efforts in this regard to modernize our payments system. Have you had any estimates as to how much money the government can save as a result of this legislation?

Mr. FERGUSON. What we know overall, not just the government, but overall in the country, the cost of processing checks is about 50 cents per check, which is about $20 billion given that there are 42-43 billion checks written. It is very hard to get a sound estimate of the savings that would emerge out of this proposed bill for the following reason. The way the bill works, it is really up to each individual bank to decide the degree to which they want to pursue this process of creating substitute checks, as opposed to sending paper checks through the system. The bill does something very clever, and I commend you for it, it puts the onus, if you will, on banks to look at both the benefits and the costs to determining whether or not they want to pursue this path. Since we do not know at this stage the answers from all of the banks that might be open to using a substitute check, it is very hard to figure out what the cost savings would be.

I would also encourage you—I know there will be some bankers who may have some experience and some exposure in this area—they may be able to give you the individual institution's perspectives, but we have not attempted to try to quantify particular savings here for the country overall, recognizing that there are decisions that will be made by individual institutions.

The CHAIRMAN. Thank you.

Mr. Fenner, NCUA adopted truncation back in 1980, and it did so even though there were some objections raised by the opponents for such a change. What has been your experience in this change? Is there any potential undue harm done to consumers because of the system that you have developed?

Mr. FENNER. The potential is always there, of course, but our experience has been very positive.

The CHAIRMAN. Have you had any horror stories in those 20-some years?

Mr. FENNER. No, we do not. We actually first authorized sharedrafts for credit unions way back in 1974. From that time until 1982, we required truncation. We stopped requiring it when we deregulated in 1982, so for the last 20 years, it has been the choice of each individual credit union whether to truncate the drafts or return them to the member. There is something in the range of 6,000 credit unions offering sharedraft programs today. Over 90 percent, over 5,000 of them still make the choice to truncate. What that suggests to us is that they find it to be more efficient and that their members accept it.

The one specific piece of information I can give you about consumer complaints is that we did survey our regional offices. In the last two years, we have had only two complaints come to our atten-

tion from credit union members, and those were complaints about the fees that they were assessed for obtaining an original or a copy of a draft that they needed.

The CHAIRMAN. If you could just take me briefly through—I am a member of the Wright-Patman Federal Credit Union here on the Hill. I write checks to all kinds of folks. Take me through the process as to how the system works today, versus what it was before 1980. I would not notice any real difference unless I insisted on having my canceled checks, right?

Mr. FENNER. The only difference which I think is immaterial to the credit union member is that until 1980, credit unions were required to use what we call a payable-through bank and truncate at that point. Now, they are allowed to truncate at the credit union, at their corporate credit union or at their other processor. But in all of those situations, it is the case that truncation for credit unions takes place very late in the clearing process, either at the credit union or at the point where their processor receives the draft.

The CHAIRMAN. It is true, though, that the sooner in the process, earlier in the process you can truncate, the more savings that are acquired?

Mr. FENNER. The more cost-efficiencies in the collection and processing of the system, and that is why most credit unions truncate today. This legislation, if it were enacted, would give them the ability to truncate at an earlier stage and provide more efficiencies.

The CHAIRMAN. Very good.

My time has expired. The gentlelady from California, Ms. Waters?

The gentleman from Texas?

Mr. BENTSEN. Thank you, Mr. Chairman.

I do have a couple of questions. Governor Ferguson, the bill has certain consumer protections that I want to ask you about, then I want to ask you about the whole clearance and payments. This is a pretty low-tech issue, but thinking about this bill, I have had a couple of experiences of my own. I was talking to staff about one where I had paid a phone bill back in Texas, and went through a six-month debate with the phone company over whether or not I had actually paid the bill. Finally, they said you are going to have to send us a check, and my bank has an image form check that they give you of just the front. So then I had to order from the bank the image form front and back and fax it to the phone company, which of course was a disaster because then they could not read the fax. Ultimately, seven months later, the phone company realized that the check I wrote them for $39.50 or whatever it was had been deposited in a wrong account and so they credited my account and we worked it all out and the phone company did not go bankrupt because they did not get my $39.50.

I had another instance where I had a check from a prior employer some years back that I deposited in my account, and for whatever reason the number was misread on the back and it did not go into my account, it went into some omnibus account within the bank. Ultimately, I went back to my employer, got the check as it cleared. They found that in fact it did not go in there. Well, it was a de minimus amount of money, it was not a huge amount.

Nonetheless, how are we certain that this bill will be structured that everyday consumers are certain that they can make sure that their funds end up where they are supposed to, and they do not have to pay $10 fees or $15 fees to get a copy of the check just to make sure that they are protected? I understand the high-tech aspect of this, and it makes perfect sense, but how are we certain that this bill will protect that? And then I have a follow-up question.

Mr. FERGUSON. Very good questions. Obviously, many of your two anecdotes deal with things outside of the banking system. They deal with the telephone company and their ability, so we should recognize that some of these problems are not in the world of the check. To answer your specific question about how we can be certain, one of the things that the bill does is it creates again in the institution that initially decides to convert the check from the original paper to the image that you are looking at now, a number of warranties and indemnities that travel throughout the system. The warranties are quite important. They say two things basically from the original bank that converted the check. It says first that this image is an accurate image of everything on the check that is relevant to the payment process. And then the warranty also says that there will not be any double-debits of the type of you might have mentioned, or you sort of implied.

It is quite important, because if you look through the rest of the bill, when you get to the section that deals with indemnities, where in fact all the banks in the line, but ultimately the one that originally converts the check, agree that if something goes wrong and they are notified of it, that they will indemnify for the results, the bad things that have happened. Under the part where it deals with warranties, they will not just simply pay whatever the face value of the check was, but also any of the damages that the bill calls proximately caused by the failure of those warranties, which gives a potentially very broad range of protections. It also gives the banks involved in this an economic incentive to get it right because they know that if at the end of the day if they do not get it right, they will have to pay potentially not just the face value of the check that went wrong, but if it is the failure of the imaging process or the use of the image or the electronics, they may have to pay a broad range of damages that resulted from that failure. That is really I think a very strong set of consumer protections.

Mr. BENTSEN. I appreciate that.

Let me ask another question before my time is up. The way I understand this Act from your testimony, the clearance system could almost work electronically, and even though banks conceivably could do it now under the law, it would be mandated now so that I write a check on my account at Wright-Patman or wherever, or Acme Bank and Trust in Texas, and it goes to Acme Phone Company—they clear that check almost simultaneously. Does EFAA give the Fed the authority, then, if this were to become law, where there is same-day settlement on the check so that the money comes out of my account—basically, are we going to be able to shorten the time frame with which funds are available from what it is under the law?

Mr. FERGUSON. Let me give you some facts and then answer your question. First, now about 93 percent of checks clear overnight. We should recognize that we really have an extremely efficient check processing system. This bill, if it becomes law, will make it dramatically more efficient, but we are working with a system that is pretty efficient. There might be a few pockets of change where you would see that come down because of this for sure. Under the EFAA, Congress has in fact required the Fed to reduce the holds on most checks to try to get things moving sooner and we will continue to follow that process. If the banks under this law, which is really not mandatory, really quite optional—it does not mandate truncation; it mandates only they accept the electronic image which they may then—someone may reconvert to paper. If as a result of this indeed time is compressed, then under EFAA the Fed should be watching that closely. If it does lead to that kind of result, then that is what we should do. It is not clear to me yet what the result is going to be, but obviously that is what the—

Mr. BENTSEN. Madam Chair, if I might very quickly, this is very important—right now, if you deposit an out-of-town check in your account, I think it is a two-day or three-day hold period on the check.

Mr. FERGUSON. Right.

Mr. BENTSEN. If in fact that check can clear immediately through an electronic image, should the consumer—in what is in effect same-day funds for the banks—should the consumer get same-day funds as well?

Mr. FERGUSON. We should be careful about understanding what happens in terms of the clearing. What this will allow to have happen first is moving the presentment faster. The bank will then still have to see if there is sufficient funds. They will have to go through their process to see if there is a return. And so while the process will speed up quickly, I do not want to leave the impression that everything happens sort of instantaneously. So to keep going, to answer your question, insofar as there are benefits that emerge here, and again we have not seen them all yet, the EFAA does require us to monitor that closely and to change—now, as you observe in some cases, a three-day hold or a two-day hold for some checks—to change that. I do not know yet if that is what will happen, but that is what the EFAA requires us to do. So by definition, we will have to monitor closely and change the holds that are required here. But we also want to understand how all this works before I can commit to you that it will definitely come down exactly the way you have suggested because we do not have the facts yet. But the law requires us to monitor closely and to respond in the way you indicate, but I cannot in all honesty commit that is—

Mr. BENTSEN. That answers my question. Thank you, governor. Thank you, Madam Chair.

Mrs. KELLY. Thank you very much.

It apparently is now my turn to question, and I have a bit of business I need to do first, and that is I have two letters that have been handed to me—one from the Information Technology Industry Council and another from the NAFCU that I would like, with unanimous consent, to enter into the record. With unanimous consent, so ordered.

[The following information can be found on page 112—113 in the appendix.]

Vice Chairman Ferguson, I want to make it clear that I am a supporter of Congressman Ferguson's bill, but I am wondering what the Fed would think about going further than the bill? Currently, the bill allows checks to be truncated when the bank in which it is deposited receives it. What if we were to expand truncating to the point of service? Is this something that the Fed would consider? Would the Fed support further refinement and clarification of the rules to eliminate the paper checks from the system at the retail level?

Mr. FERGUSON. My view on this is that what we should do first is observe how this works. This gives a number of options. It does not mandate truncation. It allows it to happen. If it turns out that indeed this process works very well, then I think Congress—not the Fed—the Congress should be open to thinking further. This bill does not mandate truncation. So my perspective on this is that we need to see how this bill works.

The other question that is important here is the question of these warranties—the consumer protections I talked about. It is quite important to understand that if the bank is willing to provide the same kind of consumer protections that are discussed here, that might make your proposal in some sense easier. It is quite important that we understand where the warranties are and that the interaction between benefits and costs or risks are similar to what is in the bill. So it is really a possibility. But my advice, frankly, is to work with the structure that is here, observe it, see if we can expand quickly, and that may allow us to go in the direction you are talking about. But I see no reason why we would object to what you have said. Being a cautious central banker by definition, I would like to see how this first approach works before I firmly say that what you propose is the obvious thing that must be done relatively quickly. And it does depend again on managing this question of warranty, so we that we can keep the level of consumer protection at the right level.

Mrs. KELLY. I think there is some concern on the part of retailers. I think they are concerned about routing information on the check reflecting the financial institution, where the check is drawn; intentional mutilation of the checks, the MICR line on the checks. I think the retailers are also concerned that they may not be given the customer's identifying information on a returned ACH item. That is why I brought this question up. I do not know if you have thought about those things or have an opinion on them or not, but if you do, I would appreciate hearing.

Mr. FERGUSON. I have thought about it a bit, and I am obviously being forced to think about it here again. I am not sure that there is, while I respect everyone's degree of concern about something new, I am not sure that there are sufficient facts to support some of these concerns. The current check procedure, for example, has very little of the kinds of problems that you have just alluded to, and I see no reason to think that because we are under this bill allowing the option of taking a check and turning it into an image, that the kinds of concerns you have raised, or other fraud or misbehavior concerns, should necessarily rise. There is nothing inher-

ent in taking one piece of paper and converting it electronically to another piece of paper that creates the kinds of problems that you have alluded to.

The same thing applies with respect to return. In order for a return item to work smoothly, then you have got to have the right set of ABA numbers and return identifiers on the check in order for this whole process to work. And so I again think that while in a new world that is being discussed in this bill one might have some concerns, but I do not think the kind of concerns that the retailers appear to be raising strike me at this stage as a credible set of concerns that should slow us down in thinking through this process.

I go back to the other point with respect to warranties. Again, the incentives on the part of the bank that decides to use electronics to convert the original checks to a substitute check are to do it properly because the cost to that institution, while it is hard to predict at this stage, could be larger than simply the amount of money to be paid on the check because of the point that I have made in response to the earlier question with respect to damages that may flow from it. So the incentives are all to do it right, and the reality of this process is such that I do not think it creates any new opportunities for fraud or misuse of the paper check. So I am actually, while I always respect those who are concerned, am relatively calm that the kinds of concerns that you have raised seem to me very remote and highly unlikely possibilities.

Mrs. KELLY. I want to ask one further question. Since we are talking about the element of speed here, I want to know whether or not you would expect the Fed to reduce the amount of time that banks put holds on deposited checks, if that is something that you have any idea about or how short this time could become. It seems to me that that is a potential possibility that we could look it.

Mr. FERGUSON. Well, as I said in response to the earlier question, the EFAA does require us to continue to monitor this. We recognize that now we have got holds that, depending on where the check is written, are in the three-day range. I want to be careful not to commit to anything at this stage, but on the other hand I also want to say that the law requires us to continue to look down this path and we will obviously continue to do that. If this process as envisioned in the Act if it becomes law suggests that indeed there is room to reduce the degree of holds, and by definition that is what we are mandated to do. And so that is what we will do. The law will not push us there. I think it is the result of behaviors and observations of changes in behaviors that may allow us to go to that point.

Mrs. KELLY. Thank you very much.

Mr. Hinojosa?

Mr. HINOJOSA. Thank you.

I would like to ask a question of Governor Ferguson. In following up with the questions that my friend from Texas, Ken Bentsen, was asking, are there any time limits on how quickly the banks and the credit unions must respond? If there is not, should there be one?

Mr. FERGUSON. If you look in the proposal as written, the consumers have 30 days, potentially extended to another 30 days, to

inform a bank that they recognize a problem. The banks then, and I think in this one it is 10 days they have to—10 days in order to respond to that and to do if appropriate an initial recredit. There are some safe harbors that might allow the banks not to do that if it turns out that there have been, for example, any evidence of overdrafts or it is a brand-new account. But the answer to your question is basically after the 30-day or 60-day notification from a consumer, 10 days for the original recredit, and the amount to be recredited is either the lesser of the face amount of the check or $2,500. When we did some research on this, the $2,500 covers the vast majority of checks that are being written. So given the fact it is unlikely to be a major problem, I think again the range of days here one could argue is certainly a reasonable place to start discussion.

Mr. HINOJOSA. Are small-and medium businesses utilizing this new technology to try to pay off a bunch of their bills electronically? If not, why?

Mr. FERGUSON. What we have noticed over the history of checks over the last 25 years or so, one is that the number of checks seems to have peaked about 1995 and has come down. But more interestingly, the average value of checks has also come down, which is suggesting that businesses in general are starting to use these technologies. The question of small-and medium-size businesses versus large businesses I think is one in which our data does not give us a clear answer. However, I would say that small businesses and medium-size businesses have exactly the same incentives as any other business to try to become much more electronic, because if you get the canceled check back then you have a real question of storage.

If you find that what you have gotten—and this law allows, by the way, to get paper back, as I have indicated a couple of times, if what you find is that you are working with an institution that truncates checks, and about 30 percent of the checks in the country are now truncated, then you get more than enough information to link to the books and records of your system. So from my perspective, I know that businesses in general, or those who have tended to write larger checks, have moved more in the direction of electronics. We know that about 30 percent of checks are truncated, and I think small-and medium-size businesses should have exactly the same incentives as any other business to go down that path.

One of the things that has been difficult in the world of electronification of payments overall is the linkage between the payment system and the back office books and records of many businesses is at this stage pretty much nonexistent. So it makes it very hard to have end-to-end electronics. This bill as proposed would do nothing about that, and I am not suggesting that it should, but perhaps one of the challenges for small-and medium-size businesses is indeed that it is very hard to get the kind of interfaces that some large institutions have at this stage because the services, while they are available on the part of the banks, the investment on the part of a small business may be more than they want to take on.

Mr. HINOJOSA. How do you feel if our committee were to request that the banks do whatever it takes, through surveys or through

forms, to be able to tell us whether the small and medium businesses, and even we could go further and say those that have the small business designation, are utilizing it, so that if they are not, that we can try to possibly earmark some money and do some education and help to those so that they can keep up with all of this technology that is available.

Mr. FERGUSON. Obviously, I think in large part you should ask the banks what they think about that. Obviously, one of the things that is proposed here that one could talk about is the need to have consumer education broadly defined. So insofar as that consumer education includes any customer that comes into the bank, I think it is written as ″customer″—then that would pick up small-and medium-size enterprises as well, so they would be educated as are you and I with respect to what at least a substitute check is insofar as that becomes part of what they are doing. But certainly, I would say talk to the banks about their willingness or interest in doing this, and obviously if the wisdom of Congress suggests that there be money put forward from Congress to help in the process, that is always something to which I obviously could not object.

Mr. HINOJOSA. Thank you, Mr. Ferguson. And thank you, Madam Chair.

Mr. GRUCCI. Thank you for your statements and your comments. Madam Chair has left and she will be back shortly.

[Laughter.]

Mr. HINOJOSA. I apologize.

Mr. GRUCCI. That is okay.

The chair recognizes Mr. Watt for his questions.

Mr. WATT. Thank you, Mr. Chairman. I will be brief. I want to apologize to the witnesses for missing their testimony, and just have one question of Mr. Ferguson. If I understand correctly from your response to earlier questions, about 30 percent of the process is currently using some variation of this?

Mr. FERGUSON. About 30 percent of checks are currently truncated.

Mr. WATT. In the same way that this bill basically provides for?

Mr. FERGUSON. Well, this bill does not mandate truncation, as you know. It just simply makes that an option or makes it perhaps a more attractive option because it allows for this new form of paper called a substitute check. What is currently happening with truncation is not that substitute checks exist. There are two things that are happening with truncation at this stage, and our credit union friend may also want to comment on this. One is that it is just purely electronic from end to end, if you will, and paper does not follow. More of the truncation I believe is a truncation with the original check to follow. And so we have some experimentation with truncation—some of the experimentation is 30 percent.

Mr. WATT. So would it be fair to say that you do not view this as being anything radical that is being proposed?

Mr. FERGUSON. I do not view this as being radical in the least. I view it as moving things forward.

Mr. WATT. You made some passing reference to possibilities of improprieties taking place in the system as it exists now. Are you satisfied that the technology is such that those possibilities are either not increased or even reduced?

Mr. FERGUSON. I am satisfied that those possibilities are certainly not increased. They may be reduced because this process allows what is called the return side of the process to go much more quickly, which is just saying if the individual finds that he or she has been given a check to which there is insufficient funds in the account on which the check is drawn, or that account has been called, will learn about that more quickly under this process.

Mr. WATT. I understand the advantages of that. What I am concerned about is it does—I just want to be clear on whether you think the possibility of other forms of inappropriate activity such as hacking into the electronic process—things that I guess if you hack into the system now, you hack into it and you take the check. Are you satisfied that the electronics of this do not increase the risk to customers? I guess that is the bottom line.

Mr. FERGUSON. To be very clear, I am satisfied—to answer the question the way you phrased it—I am satisfied that the electronics of this—

Mr. WATT. The technology, I guess. Electronics is not the future word—the technology, yes.

Mr. FERGUSON. I am satisfied that risks do not go up.

Mr. WATT. Okay. I appreciate your response, and unless Mr. Fenner has some affirmative response, I will yield back the balance of my time.

Mr. GRUCCI. The gentleman yields back the balance of his time.

I have just one quick question for the vice chairman. We are going to change a policy that people who have been accustomed to doing for a number of years, and in fact when we have questions now in our own personal home financing, my wife will go back to the checks or I will go back to the checks and pull that one out. People have become very accustomed to that. I understand that in the modern age we try to speed things up and we try to make them even more efficient than what they have been.

By truncating the check process and allowing it to be done through the Internet, how do we compensate, A, for those people who may not have access to an Internet, or have access to a public library or do not live in a community, or simply do not know how to use that system? What will be happening to those people? How will they track their checks and their records?

Mr. FERGUSON. Let me be very clear. This bill that we are discussing now does not require truncation. For an individual who has received a piece of paper called a check, this bill still allows that individual to receive a piece of paper that shows exactly the image of the check front and back as it has gone through the system. It also will have a little stub on it that basically says, this is an image of your check and it is the lawful equivalent of your check. So while 30 percent of the people do not get checks back under truncation currently or 30 percent of checks are truncated, for those who want to hold onto a piece of paper to prove that indeed a bill was paid, nothing in this law as far as I can read I will stop them from doing that if their bank continues to offer that service. There is nothing in this law that requires a bank to stop offering that service.

So if you are with a bank today that will give you your check back, as long they do not change their policy, and this law does not

require them to change their policy, then you can get either, depending on what happens in their system, the original check if they have just only gone with the original, or you can get another piece of paper that is about the same size of the check that has all of the information on it. So those who are used to getting back month to month a small packet of paper that has gone through the system will get once a month a small packet of paper that has gone through the system. Now, I happen to not do that, and I have heard Ms. Waters describe that she does not do that, but there are people who do and there is nothing in this bill that will mandate any bank to stop doing that.

Now, the bill would allow banks to decide if it is in their business interest to try to encourage or incent their customers to move away from getting those pieces of paper and some of the benefits that might accrue to the banks may also accrue to customers, which is true of many services in banks, for example ATMs. But for an individual who wants that paper and must have that piece of paper, they can get a piece of paper that shows them all of the information they need to sleep comfortably at night. I therefore think that from your standpoint, if anyone is attached to a canceled check, they will get something that should give them exactly the same degree of comfort.

Mr. GRUCCI. Providing that the bank continues that kind of a policy. If the bank chooses not to, how would they then get that document?

Mr. FERGUSON. Well, there are a couple of things. One is they can always call the bank and get the information, if that is very important. Individuals will keep track of, presumably if they fill out their check register properly, the check number and the amount and the payee. They can always call the bank and ask for the image, and that image because it would either be the best evidence available if they needed some evidence; it would be potentially a substitute check if they have gone down the path of creating substitute checks; or they can go back to the process and get the original check if it still exists.

The other point to make, if you look at the indemnity section here, if the original check still exists, there would be incentives for the bank to bring that forward. If the original check does not still exist, there are still important warranties and indemnities about the quality of the substitute check and the information thereon. So if something has gone wrong in the system, the fault will go back to the institution that originally got rid of the original check and went to the substitute. So there is plenty of room to get all the information that either will come to you regularly or through a simple phone call you can get it, or on the Internet or going to your bank to get it. So if you have a banking relationship, the bank still has the information, if they have not sent it to you in one form or another, and it is a simple question of picking up the phone, going to the bank, going to the Internet, et cetera. And there are many different ways, and in some cases on the ATMs, I suspect, may emerge—you may hear from the NCR representative about that.

So I would say insofar as information matters, you need not worry. My staff has just send me a note here that part of the answer I was not going to give you, but to make them happy, I will.

[Laughter.]

By definition, if you do not like what your bank has done, you can go to another bank. The reason I did not give that answer originally, is having been in the process of opening and closing checking accounts, I know it is not an easy thing, but by definition if you do not like what your bank has done, you can always move to another bank. So when all is said and done, all these centers are to serve customers fully through a range of services that respond to their needs, either to encourage them to stay or to go to another bank.

Mr. GRUCCI. For the benefit of your staff, if all the banks are doing the same thing, it really does not matter which bank you would go to. If they are all competing with each other and one bank is not, then they all are not going to do—

Mr. FERGUSON. Let me jump in and defend something here, though. If there is a broad demand among consumers for getting pieces of paper back, banks are profit-maximizing institutions, there will be banks that provide that. There will be banks that will advertise that as a service if there are sufficient numbers of consumers that want it. Under this law and under basic economics, the probability that all banks would do only one thing is very low if there are consumers who want some other service, just as we know all shirts are not white, though I happen to wear white shirts all the time.

Mr. GRUCCI. I see that my time has expired. I will take the liberty, though, of just asking one final question. What happens to all of these checks? Where do they go?

Mr. FERGUSON. There is a process called safekeeping, where the bank that originally receives them may store them for a period. I think frankly to be honest with you, in the credit union and other systems, that period in which they are stored is a relatively short period of time. In other cases, it may be a very long period of time, but there need be no concern about that because the way laws in general operate, there is a concept called ″best available evidence.″ If the original check is no longer available, then the image becomes the best available evidence and everything flows off of that. So the existence or lack of existence of the original check from the standpoint of anything that a consumer might care about really should not be that major a deal because laws are structured to allow for whatever the best evidence is to come forward.

Mr. GRUCCI. Thank you.

Are there any other further questions from any of the members? Hearing none, I would like to thank the panel for their time and their consideration and their insight on this issue. The chair notes that some members may have additional questions for the panel which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for the members to submit written questions to these witnesses and to place their responses on the record. I will adjourn the first panel and convene the second panel.

Let me take the liberty of introducing our next panel. We have first Mr. Curtis ″Curt″ Hage, chairman and CEO of the Home Federal Bank; Ms. Gail Hillebrand, senior attorney, Consumers Union; Mr. David Walker, president and CEO, Electronic Check Clearing

House Organization; Mr. Lee Schram, vice president and general manager of Payment Solutions, NCR Corporation. For the purposes of our final introduction, I yield to my colleague, Mr. Pat Tiberi.

Mr. TIBERI. Thank you, Mr. Chairman.

It is a pleasure for me to introduce a constituent of mine. Joe Biggerstaff has served as the AirNet Systems chairman of the board since August of 2000, and has served in other capacities since March of 1999. He has worked in the transportation industry for 23 years. AirNet is an integrated air transportation network based in Columbus, Ohio in my congressional district, and the system operates between 100 cities in more than 40 states and delivers over 18,000 time-critical shipments each working day. It is the leading transporter of canceled checks and related information for the U.S. banking industry, meeting more than 2,200 daily deadlines. So it is great to have you here, Joe.

Mr. GRUCCI. Thank you, Pat.

Without objection, your written statements will be made part of the record. You will each be recognized for five minutes in summary of your testimony, and we will start with Mr. Hage.

STATEMENT OF CURTIS "CURT" L. HAGE, CHAIRMAN AND CEO, HOME FEDERAL BANK

Mr. HAGE. Mr. Chairman and members of the subcommittee, I am Curt Hage, chairman and CEO of Home Federal Bank in Sioux Falls, South Dakota. I am chairman of America's Community Bankers and I am here today representing the five major banking and financial services trade associations—ACB, the American Bankers Association, the Consumer Bankers Association, the Financial Services Roundtable, and the Independent Community Bankers of America.

I am pleased to present our views on the proposed Check Clearing for the 21st Century Act—Check 21. It is somewhat exceptional that all of our groups fully agree on any topic. However, we all support efforts to increase the efficiency of the nation's payments system that benefit both consumers and financial institutions. I would like to extend our appreciation to both Chairman Bachus for holding this hearing, as well as to Congressman Ferguson and Congressman Ford for introducing this legislation. We also appreciate the outstanding efforts of the committee and Federal Reserve staffs who have worked tirelessly to address the issues of all concerned.

While electronic payments are increasing, traditional paper checks remain the dominant form of non-cash payment. Checks will continue to play a significant role in the payment system for years to come. Processing these checks is enormously expensive and labor-intensive. Current law generally requires physical checks to move through the entire clearing process from the bank of first deposit to the payer bank. While physical checks continue to move through this process, an increasing number of consumers do not have their original checks returned to them. Instead, they receive detailed information about their check transactions in their monthly account statement. Passage of legislation like Check 21 will build on this experience and facilitate efforts to remove paper checks from the settlement process. Those banks that choose to

process paper checks could use substitute checks that would retain the legal equivalence of the original.

Most importantly, the proposal does not require the industry to adopt a fully electronic check clearing system. We could adapt to electronic check clearing over time without interfering with the existing paper check process. Expanding electronic check processing will also minimize the effect of unexpected disruptions to air and ground transportation systems. It will result in faster check collection, make funds available sooner, and help combat fraud.

Check 21 will also help increase the use of check imaging. Many consumers already benefit from this process. Rather than dealing with bundles of canceled checks, consumers receive concise and convenient summaries of their transactions. Many can access check images on the Internet, helping them to quickly verify their transactions, identify potential errors, and detect fraudulent transactions sooner. Identifying errors and potential fraud quickly helps banks minimize customer inconvenience, control losses, and gives law enforcement an important time advantage.

Check 21 could provide real benefits to rural communities. In South Dakota, we are constantly challenged to meet our federally mandated funds availability deadlines due to adverse weather conditions and limited access to air courier services. One Home Federal branch operates in a remote part of the state that is nearly a five-hour drive from our central processing point. We often have just enough time to meet the federal funds availability requirements. Home Federal customers pay a premium for moving checks across the state. Check 21 would allow Home Federal and other rural community banks to transmit electronic images of checks rather than sending them on unnecessary physical journeys.

Some critics are concerned about relying too heavily on check images. Our industry's experiences show that these concerns are unfounded. Home Federal began offering checking accounts around 1980. From the beginning, we provided customers with the convenience of check safekeeping. They receive detailed information about checks drawn on their accounts, while the original physical check is microfilmed and stored at our check processing facility. Consumers receive a convenient summary of transactions and avoid the burden of receiving and storing reams of canceled checks. Banks reduce mailing and handling costs. These savings can be passed on to our customers.

Home Federal began offering the option of having checks retained several years ago. Still, fewer than 10 percent of our customers choose this service. Home Federal will soon offer full image statements of processed check and online access to images. We expect that once these image products are available, almost all or our customers will choose not to have their original checks returned.

Check 21 makes no fundamental change in existing check law, so we believe that new consumer protections are not necessary. The banking industry and millions of consumers have an established history of dealing with truncated checks and image documents. This experience demonstrates that existing law provides adequate protections. Check 21 establishes a complicated expedited recredit and reversal and recredit structure for consumers and banks. The

banking and financial services trade associations believe this provision is unnecessary and may result in unintended consequences.

Today, banks respond to customer claims of check fraud or processing errors in a timely and effective manner. Complaints are rare. In fact, Federal Reserve staff has indicated that an informal review of the consumer complaints filed with all the banking regulatory agencies reveal no significant consumer issues relating to existing check protections. Complicated new recredit procedures would confuse customers, create compliance headaches for banks, and expose banks to fraud.

Our associations support the general principle outlined in the Check 21 Act to facilitate innovation in the check collection system. We believe, however, that existing law and regulations work. We urge Congress to preserve existing law with respect to substitute checks authorized under this proposal.

Thank you for considering our views.

[The prepared statement of Curtis "Curt" L. Hage can be found on page 70 in the appendix.]

Mr. GRUCCI. Thank you, sir.

I should have pointed out at the beginning of the testimony that there are a series of lights. We try to stay within five minutes. We are not going to ask you to truncate your statements, but certainly we would ask you to monitor the lights, and if you can stay within the five minutes, that would be great.

Let's move now to Ms. Hillebrand.

STATEMENT OF GAIL HILLEBRAND, SENIOR ATTORNEY, CONSUMERS UNION

Ms. HILLEBRAND. Thank you, Mr. Chairman and members. I am Gail Hillebrand from the West Coast regional office of Consumers Union. Since 1936, Consumers Union has been in the business of protecting U.S. consumers and their interests. Our mission is to test, inform and protect. Needless to say, I am in the protect part of our organization. My written testimony today is joined by several other national consumer organizations—Consumer Federation of America, U.S. PIRG, and the National Consumer Law Center.

Let me start by saying we are not against technology and efficiency. However, we are against the Check 21 Act in its present form. I will tell you why. We think that Congress needs a very good reason before disturbing the existing payment and financial management habits of somewhere above 45 million U.S. households. We are concerned that the Check 21 Act essentially changes the processing of checks to be much more similar to the processing of electronic payments of other kinds—debits and electronic funds transaction acts such as your regular recurring mortgage debit, without providing the same protections to all consumers.

The Act is ingenious in that each consumer who now gets their original paper check will get a different piece of paper called the substitute check. But the Act does not guarantee that any consumer can receive a substitute check, and you heard Governor Ferguson say that will be up to the marketplace. The Act also does not guarantee that any consumer can get the original if the consumer needs it for a particular reason, such as a landlord or a phone com-

pany who does not understand the ″best evidence″ rule and wants to see the original, not whatever the bank has on hand.

The original will not even be at the consumer's bank anymore. It will be somewhere else in the check processing. Quite a bit earlier in the processing scheme than today, where usually if you have truncation at all, you have got it right there at your own bank or at the pass through bank. Passing this Act would permit banks to blame any customer dissatisfaction with this change on Congress. Sorry, we cannot give you original checks back anymore. Congress says we can give you this piece of paper instead. That will not be quite true, but if your bank no longer has the original check, they will not be able to give it back to you.

We estimate 45.8 million U.S. households are now getting their checks back. That is a very conservative estimate, because it is based on numbers that were provided by members of the banking industry about the percentage of consumers who get so-called voluntary truncation now. The numbers we heard this morning from Dr. Ferguson would suggest quite a higher number of households getting their checks back, because he said it was only 30 percent nationwide who have truncation.

So what is the difference? What is the new error rate—the new potential error? We do not know because this system has not been used. But we do know that Congress has said when we have electronic funds transfers, we have consumer protections in the nature of a 10-day recredit under regulation E, and an ability to get that money back into the consumer's hands for use very promptly. You have something in your Act in section six that looks very much like the reg E 10-day recredit. The reason it does not work and cannot work for consumers is banks can take it away simply by saying to the consumer, look, you are not going to get back your original check anyway, so we would like you to just say we are not going to send you these foolish paper substitutes either. Instead, we will give you electronic image; we will give you online image; we will give you a set of copies, but they will not be the legal equivalent to your original check and you will not get that protection of the 10-day recredit.

We do not know exactly what the new risks are. We suspect they could include duplication of the electronic image so that the check is paid twice, or what was described at one of the many meetings on this Act before the Fed, leakage of the original check back into the check system, so that both the original and the image might move through and at some point become two electronic images.

Since the Fed estimates only one-quarter of checks are subject to electronic presentment now, that through bank-to-bank agreement, we cannot know what will happen if that is 100 percent of checks, or some number higher than the current level. But we do know that existing law gives us rights as consumers when we pay with our debit card and we do not think it makes any sense to say, if you pay with a check, you have one set of rights; if you get not your original, but these substitute checks back, and a different set of rights if you do not get your substitute checks back.

I would also note an important issue related to consumer privacy. There is a lot of personal information on a check. It is available now. People could pick it up off the check. But it is expensive

to pick information up off of paper, and when that information can be picked up off of electronic images, we have a greater risk for privacy.

You will be hearing from my colleagues, the bankers, that check truncation has been around for decades—it is not really a problem. We do not know whether it will be a problem because consumers have been able to choose yes or no to check truncation up to now. This will essentially prevent the consumer from getting the original returned on a regular basis. That means it would not be surprising to have a small number of complaints from consumers who have chosen check truncation voluntarily, but when it is imposed on them, we may see some different results. But even taking the bankers' numbers—they gave us an estimate in one meeting of 1.1 billion checks and 480,000 customers asking for their checks back—if you take that same ratio on the 35 billion checks written per year in the U.S. or maybe a little higher according to the Fed's testimony, that is 15 million consumers a year who need their original check for one purpose or another. That is a lot of people.

I would like to close by talking about what is not in this Act. We see the key thing that is not in the Act is a right of recredit that applies to every check which is not returned to the customer—every check that is electronically imaged along the way, regardless of what the very last step is where something is or is not returned to the customer. We also see that it has no privacy protections for the use or creation of databases containing information about consumers' payment habits in checks. It has no requirement that checks be credited to consumers any sooner. You heard Governor Ferguson say quite accurately that the Fed is not making any commitments at this time in that regard. It places no obligation on the bank to every provide the original check when the customer feels that they need that check. It places no obligation on the bank to provide the substitute check if the customer is not previously set up for substitute check returns. It places no obligation on the bank to offer accounts that the customer can use for substitute checks, and it places no restriction on how much more those accounts might cost than other accounts.

We respectfully suggest that if Congress is going to revamp the check system to give all of us the benefits of additional electronic efficiencies, it needs to do so in a way that gives consumers the same protections for electronically imaged checks that we have for other electronic payments.

Thank you.

[The prepared statement of Gail Hillebrand can be found on page 77 in the appendix.]

Mr. GRUCCI. Thank you very much for your testimony.

Mr. Walker?

STATEMENT OF DAVID WALKER, PRESIDENT AND CEO, ELECTRONIC CHECK CLEARING HOUSE ORGANIZATION

Mr. WALKER. Mr. Chairman and members of the subcommittee, my name is David Walker. I am the president of the Electronic Check Clearing House Organization known as ECCHO. I am very pleased to be here today on behalf of ECCHO to discuss the Check Clearing for the 21st Century Act. ECCHO applauds Congressmen

Ferguson and Ford for introducing the Act. We also commend Chairman Bachus and this subcommittee for holding a hearing to consider this important legislation.

I would first like to provide some information about ECCHO and our role in the check clearing process. ECCHO is a nonprofit nationwide bank clearing house. Our member financial institutions hold approximately 60 percent of the total U.S. deposits. ECCHO has developed an extensive set of clearing house rules. These rules cover multiple check electronification scenarios, including electronic check presentment and check image programs. During 2001, ECCHO member institutions exchanged approximately two billion checks totaling approximately $3 trillion under one of the various check electronification programs supported by the ECCHO Rules. In addition, the Federal Reserve also provides check electronification services. The Fed used these services to process about 37 percent of the 17 billion or so checks they collected in 2001.

Because of our involvement with electronic check programs, ECCHO has been working with our members and other interested parties on issues relating to substitute checks since the Federal Reserve first introduced the concept a few years ago. For example, we have for some time been working with the standard-setting organizations to develop technical and operational standards for substitute checks. As I indicated a few moments ago, check electronification and check imaging are in wide use today. However, check images can be exchanged only if the bank on which the check is drawn and its customer have agreed to accept the image instead of the original check. Accordingly, banks today must support two check collection processes. They need one process for checks they send to banks and their customers who have agreed to check imaging, and they need another process for checks they send to banks and their customers who have not yet agreed to check imaging.

The Act will encourage even more check electronification. Banks will be able, if they so choose, to convert all of their paper checks to images and deliver substitute checks only when necessary. In short, the Act will help bridge the gap to a fully electronic check collection system. As a result, the Act will significantly benefit all stakeholders in the check collection process. These benefits include exciting new products and services for customers, a significant reduction in the cost of check collection, and better insulation of the nation's payments system from disruptions to the air transportation network, such as occurred after September 11.

ECCHO supports the Act as it has been introduced by Congressmen Ferguson and Ford. We do have concerns with a few provisions of the Act, and we have provided a detailed discussion of these concerns in our written statement. There is one significant concern with the Act that I would like to address here today—the January 1, 2006 effective date. There is no need for delayed implementation. Sending banks will create substitute checks only when they are ready to do so. The receipt of the substitute check also will have no adverse effect on the receiving bank or its customer. This is because the substitute check can be processed just like the paper

check, and because the Act provides that the substitute check is the legal equivalent of the paper check.

The financial services industry will shortly be ready to go with substitute checks. The industry standards for substitute checks have already been under development for over a year. We anticipate that they will be ready for use within the next few months. A delay in the effective date until January 1, 2006 will only delay the many benefits that the Act provides to banks, their customers, and the nation's payments system.

ECCHO appreciates this opportunity to present our views to the subcommittee on the Check Clearing for the 21st Century Act and I would be pleased to answer any questions the subcommittee might have. Thank you.

[The prepared statement of David Walker can be found on page 91 in the appendix.]

Mr. GRUCCI. Thank you, Mr. Walker.

Mr. Schram?

STATEMENT OF LEE SCHRAM, VICE PRESIDENT AND GENERAL MANAGER OF PAYMENT SOLUTIONS, NCR CORPORATION

Mr. SCHRAM. Chairman Grucci and members of the subcommittee, thank you for the invitation to testify today. My name is Lee Schram and I am the vice president of payment and imaging solutions at NCR Corporation. We are a global provider of financial and retail technology solutions, with over 100 years of experience in consumer transactions. NCR is the world's leading provider of ATMs and a global market leader in retail point-of-sale products. For over a decade, NCR has been providing imaging technology to banks and our solutions touch more than 70 percent of check transactions in the United States.

Mr. Chairman, I represent NCR as well as a consortium of high-tech companies, including IBM, Unisys and others. In fact, I have submitted this morning a letter from the Information Technology Industry Council in full support of House Resolution 5414. This legislation will make the check payment system more efficient, user-friendly, and provides clear direction and adequate protection for all parties involved.

Imaging technology is critical for successful bill implementation. Thus, it is important to understand the advanced state of this technology to demonstrate its readiness and to dispel concerns. Check imaging was introduced in the late 1980s. Most major and over 50 percent of community banks have been using it for over a decade. Internationally, many countries truncate checks. Imaging technology is readily available, secure and reliable today. Image quality is superior to checks, better than microfilm, and each image can be uniquely identified and linked to the original check.

While the required technology is ready, concerns have been raised which I will address. First, while consumers may not be able to readily access the original check, image technology provides them with more options to access information, including online banking and image statements, while maintaining an audit trail to the original check transaction. A second concern is the number of times a substitute document may be converted to a digital check.

Ideally, truncation would occur at original point of presentment with no subsequent conversion. However, at least initially substitutions will occur, but digital checks can be reliably created from substitute documents. Auditing processes exist to prevent duplicate entries prior to account posting, thereby maintaining consumer protection.

A third concern, check readability, is eliminated as technology allows these images to be displayed in a wide range of sizes to meet consumer needs. The benefits of the bill far outweigh these concerns. Changes in banking laws written in an era when checks were cleared across town, rather than nationwide, have not kept up with technology advances, resulting in a costly, time-consuming, and fraud-ridden check clearing process. Today, a check presented to a retailer or a bank is typically handled over 15 times. Check 21 implementation would utilize technology advances to streamline the payment process, and at the same time provide new value-added services to the consumer, like image-enabling ATMs in more convenient locations.

With Check 21, retailers, where over a third of all consumer checks are written, will now know within seconds if a check is good and fraud-free. Consumers and retailers will gain quicker access to deposits as transactions clear electronically in minutes, not days. Image-based transactions can be archived for years and quickly accessed by customers online via the bank's web site. For consumers not having online access, bank service centers will access images instantaneously upon request.

The elimination of moving paper checks around the country will take significant cost out of the system, from couriers transporting checks to mail handling. One major banks spends $25 million annually on courier service, while another spends $20 million opening envelopes. Market forces will ensure that consumers realize the savings that result from imaging. The bill will also virtually eliminate payment system logistical interruptions such as the grounding of commercial air service for several days following 9-11.

Now is the time to leverage advances in communications and information storage to facilitate a more efficient payment clearing system. The benefits of check imaging should not be withheld from consumers and financial institutions for another three years, as currently proposed.

NCR commends Director Roseman of the Federal Reserve and the Financial Services Committee staff who have worked in a cooperative manner to deliver a bill that is balanced, protects consumers and recognizes the immediate and future needs of the payment system. Through existing proven technologies, consumers, financial institutions and businesses can enjoy the benefits of checking accounts with the more effective payment system.

Mr. Chairman, I thank you and the subcommittee for your time and attention.

[The prepared statement of Lee Schram can be found on page 86 in the appendix.]

Mr. TIBERI. Thank you.

Mr. Biggerstaff?

STATEMENT OF JOEL BIGGERSTAFF, CEO, AIRNET SYSTEMS, INC.

Mr. BIGGERSTAFF. Good afternoon, Chairman Tiberi. I appreciate the opportunity to appear before this distinguished subcommittee in order to testify on proposed legislation known as the Check Clearing of the 21st Century Act. I am Joel Biggerstaff, CEO of AirNet Systems, Inc., a critical time-shipment carrier based in Columbus, Ohio.

With over 130 aircraft and with Department of Defense certification, AirNet is recognized as an industry leader in the transportation of checks, time-sensitive medical shipments, cargo charter, passenger charter, critical parts and other top priority deliveries. AirNet employs over 1,100 team members nationwide, with over 300 ground couriers supplementing industry-leading door-to-door service.

As a participant in the payment system for some 30 years, AirNet applauds your efforts to improve the overall efficiency of the nation's check clearing system. We are proud of the part our company has always played in ensuring the swift and reliable collection and processing of our checks. We estimate that AirNet flies 65 to 70 percent of all checks that are flown from point to point throughout the nation on a nightly basis. The remaining checks are flown either on the Federal Reserve's check relay network by large integrators such as UPS, or on commercial airlines.

On September 11, 2001, we, like you, were in shock at the news that our country was under attack from the air. The Federal Aviation Administration's response, of course, was immediately to ground all aircraft nationwide that morning. This was the one and the only time the FAA has ever acted to close domestic national airspace, hereafter referred to as NAS. Despite the closing of the NAS, however, we at AirNet were called upon to make several flights on September 11 for the American Red Cross under what is known as lifeguard flight status. We were in the air at 3:37 that afternoon on the first of four flights that day.

The next day, September 12, we flew another eight lifeguard flights while NAS was still closed. Our banking customers, of course, still had checks to move. To solve that challenge, we put into place a massive ground operation to cover as much territory as possible for our bank customers while NAS was closed. On September 13, with the reopening of NAS scheduled for that evening, AirNet received a call from the Federal Reserve. The Federal Reserve was requesting our assistance to coordinate the massive movement of checks that had been awaiting processing since the 11th. We were happy to respond. In fact, Mr. Chairman, we were in contact with this committee during that time to advise of our ongoing work plans and to seek logistical assistance with the Department of the Treasury in clearing our aircraft. On the evening of the 13th, AirNet helped move over 500,000 pounds of checks, five times the normal amount transported on a typical night, and moved another 275,000 pounds later that weekend.

One letter of thanks from a customer illustrates the quality of our performance, and I quote, on behalf of float management at Bank of America, I would like to express our sincere thanks for your dedication to service during the recent tragedy. Your commit-

ment to your customers has always been evident in your customer service and delivery quality, and recent events have proved your competent staff to be exceptional. Thank you again for your dedication to keeping the payment system moving, end quote. That quote is from the senior vice president, Bank of America. With your permission, Mr. Chairman, we would also like to offer for the record a number of similar commendations from our customers, including the Red Cross.

[The following information can be found on page 115—126 in the appendix.]

The FAA took the right and necessary decision on September 11. It was essential that NAS be closed. However, with all due respect to some in support of the measure being considered, reducing the impact of air service dispruption to the payment systems does not require the passage of new legislation. The impact of the disruption could have been significantly reduced, and perhaps been completely avoided had the transportation of checks in the payment system been given lifeguard status. The electronic transmission of check images is no guarantee of uninterrupted check processing. Electronic systems are much more sensitive to disruption than air transportation, and indeed cyber-terrorism is perhaps one of the greatest threats we now face.

Moreover, even with passage of the Check Clearing for the 21st Century Act, truncation would not be mandatory and air transportation would continue to be critical. Should events in the future ever cause the closing of NAS again, the air transportation of checks can be guaranteed by the simple designation of lifeguard status to these critical shipments. The electronic transmission of check information, side by side with air transportation, represents a fundamental principle of safe and sound banking redundancy. The full functioning of these two methods of check processing ensures the long-term integrity of the payment system. Indeed, a policy that dismantles the air transportation infrastructure could represent a threat to the integrity of the payment system.

In this regard, the Federal Reserve along with other agencies recently requested comment on a draft white paper entitled Sound Practices to Strengthen the Resilience of the U.S. Financial System. The white paper refers to core clearing and settlement organizations which it defines as firms that provide critical clearing and settlement services for critical financial markets in sufficient volume or value to present systemic risk and their sudden absence, and for whom there are no viable immediate substitutes. The events of last September illustrate that AirNet is a core clearing and settlement organization. Its ability to operate was and is essential to the functioning of the U.S. financial system. We therefore urge that this subcommittee during future deliberations on this legislation seriously consider conferring lifeguard status for air transportation activities associated with the payment system.

Mr. Chairman, by supporting the lifeguard designation for the payment system, by supporting the policy to protect redundancy in check processing infrastructure, and by supporting transportation as a core clearing function, you will promote and improve the overall efficiency of the payment system, which is the stated goal of the legislation.

Thank you, Mr. Chairman, for this opportunity to testify. I would be happy to answer any questions of you or members of the subcommittee.

[The prepared statement of Joel Biggerstaff can be found on page 48 in the appendix.]

Mr. TIBERI. Thank you, Mr. Biggerstaff. Without objection, Mr. Biggerstaff's documents will be included in the record. No objections.

Mr. Biggerstaff, first question is for you. You mentioned the first lifeguard flight on September 11 was approximately 3:30 in the afternoon of September 11. When do you normally take off on any given day with checks?

Mr. BIGGERSTAFF. Our system goes into operation basically at the close of the banking day. Our initial flights occur late afternoon and continue through the night until mid-morning the following morning, moving checks around the country, hubbing three times through Columbus, Ohio in the process.

Mr. TIBERI. So your point being in your testimony that if lifeguard status had been issued for that day, there would have been no interruption of service.

Mr. BIGGERSTAFF. That is absolutely correct. Our system operates independently of other systems and is very specifically tailored to the payment system needs. We could have easily functioned in a normal manner that night.

Mr. TIBERI. In your testimony, you mention that the Fed had called upon AirNet to help the day that airspace was reopened, to handle the backlog. Would AirNet be able to run its own system and the Fed system?

Mr. BIGGERSTAFF. Absolutely. The Fed system and our system are basically duplicative at this time, operating from the same points of origin and serving the same end points at the same time. With capacity availability in both systems, it would be very easy for a single management structure to create significant efficiency and improve the service of the system. I found it interesting earlier that I think the percentage of checks cleared overnight is 93 percent, as mentioned by the Federal Reserve. For those checks that flow through our system, we consistently average in excess of 98 percent in terms of on-time delivery and subsequent clearance of those financial instruments.

Mr. TIBERI. Mr. Schram, I am sorry I missed part of your testimony. I was voting. Can you talk to us about the costs for implementing a comprehensive system of electronic check presentation and truncation?

Mr. SCHRAM. The cost really depends on the size of the bank and the size of the check volume. So if you look at a large major bank in the United States—the Bank of America, for example, being the largest check volume today, about 15 percent. Their cost is going to be more just because of the volume in terms of putting the system in, versus a cost that is in, let's say, a smaller community bank. Really, volume drives the imaging technology in terms of the cost.

It depends also on how far you are going with electronification. Let me give you an example of what I mean by that. If you are just capturing the check image at truncation point, that is the capture

piece of the check. There is a cost involved in that piece and again that depends very much on the size of the bank and the volumes. Then there is also a cost to store the check in terms of the archive application. Again, that is dependent on the volume and the size of checks going into that archive.

So what we see today in our company is the size of putting in these systems. I will give you a general range. It ranges between maybe $4 million and $5 million, to $15 million. Again, it depends very much on the size. Those would be for a major bank application. Again, a smaller community bank would be—we do check imaging applications for them that are well under $1 million, as an example. So again, you have to look at check volume, the throughput, the bank process in order to really get to a finite number in terms of the cost to put in a check imaging solution.

And what we have to do in order to do this today with the banks is to prove a business case payback. We have to be able to go back to the banks and say, by putting in our check imaging solution, we are able to give you a more cost-effective operation. Generally what we do with the banks is sit down and go through how much is it costing to do an application today or run their operation today, and we have to make business-case paybacks that they put on our technology. I think that is a very important thing here. So they have to get the proof that our solutions can actually provide benefit to them and their customers.

Mr. TIBERI. So your belief is that the cost to community banks would not be prohibitive.

Mr. SCHRAM. I do not believe so at all. In fact, like I said, we are providing this technology today and similar to the major banks, they go through a payback analysis with us, and we sit down and cost-justify our solution and our technology versus the benefits it provides to the banks and their consumers. It runs the same whether you a major bank or whether you are a very small community bank.

Mr. TIBERI. NCR is a leader in technology. Some would say that if we went to this system tomorrow, because of some vulnerabilities in technology networks, peer networks, the computer infrastructure would be vulnerable from maybe some sort of cyber attack. Can you give your thoughts on that issue?

Mr. SCHRAM. Security is a major concern. It comes up often. But there is encryption technology, closed network technology that basically surrounds what we do in terms of imaging technology today that is very similar to ACH and debit and credit card technology. So the technology exists out there today. I think it is important that as you also follow the check through the capture point of the image all the way into the archive, there is archive security around not being able to change the check image that is in the archive; not be able to move things around. I mean, there is all sorts of technology both in the hardware and the software side that supports the security around the check. So it is all things that we are readily doing today and that are available today.

I might also make a comment on ANSI standards, because one of the things that we are working with is the ANSI standards committee basically to draft and develop standards around check signatures, to make sure that those signatures are only and can only be

assigned to one check. That is very important as well. So we are not only pushing the encryption and the closed network technology and strengthening that. We are also working with them on other standards that we can continue to do to even improve security even more.

Another final comment I think is very important is, paper checks today are not totally secure either. We continue to read where courier services, checks are stolen from them. There are a lot of stories out on check washing. Finally, there is a lot of fraudulent paper checks and signature forgeries that can be done as well. So I think you have to look at the balance between this. We really believe that the security is there today around imaging.

Mr. TIBERI. Thank you, sir.

I am just going to continue to ask questions here. This is a pretty good position to be in.

[Laughter.]

Mr. Walker, opponents of the legislation have objected to allowing recredits to be granted only to customers that request substitute checks instead of other forms of check truncation or safekeeping. Can you address the objections and share with me, at least, your views of why additional notification would not be a viable option?

Mr. WALKER. The history and the experience in the industry is that for the last 30 years, banks and other financial institutions have been involved in check truncation and safekeeping processes. As Vice Chairman Ferguson indicated earlier, approximately 30 percent of existing check volume does not get returned back to customers today. We would suggest that this history indicates that there really is not a need for additional protections for the consumers; that consumers are adequately protected today when they receive check images. In fact, the experience that we have gained from the banks as well as from the Federal Reserve and from credit unions and other organizations would indicate that there are very few customer complaints in the area of check truncation and imaging.

So the difference that you are talking about is in fact created by the Act itself. If there is a need for some additional protections in this more electronic process, the additional protections should only be provided to the customers where they have not agreed to get their original checks back, and they only receive substitute checks back. So the difference in consumer protections that you are asking about is in fact created by the Act itself. Even in the absence of lsuch protections, we think there is adequate protection under the existing check law, and there is no significant evidence to the contrary.

Mr. TIBERI. Thank you, Mr. Walker.

Ms. Hillebrand, I was here for most of your testimony, and your primary concern seemed to rest with the consumer's ability, the customer's inability to receive their original check back under this proposed legislation. Don't the benefits of the security issue that we talked about, the increased effectiveness, the expedited check presentation—do not those things outweigh the concern that you have, based upon the fact that we can at the end have a substitute check?

Ms. HILLEBRAND. Let me respond to that, and then amend slightly your question. We have two primary concerns, and you identified one of them, which is getting the checks back. There are a lot of possibilities that have been raised about benefit, but the statute does not require that those benefits be delivered to consumers. In the Federal Reserve Board summary of the Act, they say I think quite candidly that this could reduce bank operating costs, quote, with savings passed on to shareholders in the form of higher returns, or to consumers in the form of lower fees, unquote. We do not know whether these so-called benefits will exist for all consumers.

Certainly, some consumers are in the electronic age and want imaging and there is some customer demand for that. Those consumers are being served today in the marketplace. But other consumers who do not want that are going to lose something that they now have, which is the paper check. But more importantly, even those consumers who have said no thank you, I do not need to get my checks back, their checks will be processed differently. Their checks will be processed more electronically. You have that exhibit that Governor Ferguson gave you that shows, bank one, bank two, bank three, bank four. Today, when truncation occurs, it occurs right there at the end at bank four. Under the Act, it is going to occur somewhere near the beginning, probably at bank one or maybe at bank two. And then it will be converted in and out of electronic and substitute form. We think that that process creates for consumers the same kinds of risks that we face when we pay with a debit card. We should get the same kinds of protections.

And the Act does have some protections, but it sort of gives them in section six, and then it takes them away by saying, well, if your account agreement does not call for substitute checks, you do not get those protections after all. I have a hard time explaining this to my colleagues, and I cannot imagine explaining it to my mom, or you explaining it to your constituents. If you insist on your original checks back, you will not actually get them, you will get something else, but you will have certain rights that you will lose if you say, oh, no thank you, the copy the bank is going to send me looks just like the substitute check. I cannot get my original checks back anyway; I may as well agree to the copy; maybe the account is a dollar a month cheaper. Consumers are not going to know that they are losing that important recredit right.

So the Act kind of creates the right and then takes it away at the same time through what is essentially a waiver by agreeing to voluntary truncation. We do not think that makes any public policy sense.

Mr. TIBERI. Mr. Hage, could you comment on the same issue?

Mr. HAGE. Our experience at Home Federal has been that 90 percent of our customers have chosen to do business with us and have their checks truncated since the beginning of our offering checks. Ten percent of our customers have elected to keep a paper form. The feedback that we are getting from our customers is that when we go to check imaging, those 10 percent who are now getting the paper back have a high propensity to convert to check imaging. So the notion that there is a mass of consumers out there

who are clinging to the paper as a security blanket I think is unfounded in today's world.

This Act does not require nor force any bank to refuse to process paper. It only allows those banks who find it advantageous for themselves and for customers to now have a legal choice to use a substitute check, which facilitates then the use of the electronic form of transmitting those checks. When you think about the number of times that paper is handled, and at a minimum it is five to six times per check, think about all the risks that are embedded in that. If you can transmit this information electronically, you reduce that down to two to three handlings, and from that point on the data is secure in an electronic form that cannot be altered and can be passed on to any point of use in the system. There is certainly a lot more security in an electronic form of transmitting this kind of information. There is a lot less risk of losing, mutilating, losing, otherwise inadvertently destroying or having limited access to the paper.

I also encourage you as a committee to think in terms of the private sector forces, the market forces that are in play here that are very real. My company spends several hundred thousand dollars a year in marketing to attract customers to come and do business in our bank. We are not going to turn our backs on them and we are not going to fail to give them the quality of service that they are going to demand in order to continue to stay loyal customers to our bank. I think that is true in every bank in this country. We pay dearly to get customers, and we work very hard to keep them. So if there is a sentiment among customers that they are being mistreated or misrepresented, we are going to respond to that.

Mr. TIBERI. Just to follow up on your comments, then—you believe that if there is an outpouring of customers who say, I want my paper check, you think there will be some banks who may respond to that? Is that what you are saying?

Mr. HAGE. Absolutely, and my bank is one of them. The reason we added paper check processing to our system was because we acquired a bank where the majority of the customers at that bank were used to getting paper back. And we did not want to lose contact with those customers or drive them out of our bank to another bank. So we incurred the expense to provide paper check returns to satisfy that segment of customers, and they are very happy with the way we have done it. Our response to them now is that more competitors in our marketplace are offering check imaging, and our customers are saying, when will Home Federal do that? We are going to offer it in the next 30 to 45 days.

Mr. TIBERI. Responding to the market.

Mr. HAGE. Responding to the market.

Mr. TIBERI. Mr. Walker, do you have any thoughts on the same subject?

Mr. WALKER. I do not recall, sir, whether you were here at the time that Mr. Bentsen was describing scenarios that he had experienced earlier.

Mr. TIBERI. I was not.

Mr. WALKER. In his scenarios, he described checks that he had written and some difficulty he had in being able to get back information about those checks. These scenarios involved traditional

paper checks. One of the key benefits that we think customers would begin to see with check imaging very early on in the cycle would be improved customer service on the part of the bank, because having access to electronic records of all of those checks would make it much easier to find and then provide the answers to customers about their questions than if you had to find either a microfilm copy in storage someplace, or physically go find the paper check, if the check is safe-kept.

In this world where you would have electronic images, including pictures of all of those check's front and back, the banks' customer service areas would more readily have access to that information, and frequently would be able to answer a customer's questions while they are still on the phone, not several days or weeks later when the bank might be able to physically access the piece of paper.

Mr. TIBERI. You guys are not in the banking business, but any thoughts?

Mr. SCHRAM. Just one other thing. Think about yourself personally and if you have a check that you want to cash today, or if you want to deposit it today. You walk up to an ATM machine. The technology is coming right now and available where you can basically put that check into the ATM machine and what will happen is an image of the check will automatically come up on the screen, and it will ask you to confirm whether the deposit amount is correct or whatever. And it will automatically then be able to start flowing down the check payment system. Whereas today, you walk in, you put an envelope in and you do not necessarily know where it is going, where it is flowing. You know you put the paper in, but what you will get immediately at that point of presentment is the opportunity to know, yes, I deposited that; yes, I validated the amount; and yes, I now know that once it has left my hands now and it is going down the payment system, I will be able to know that that image is a good image and I will know immediately at that point in time, rather than waiting, and did that black hole that is just went into actually accept my check and what happened to it, and so on and so forth.

So we believe the technology is a real nice place for all parties involved in this, especially for the consumers.

Mr. TIBERI. Joe, any comments on this issue?

Mr. BIGGERSTAFF. I would like to address one comment made relative to justification from a security standpoint, from migration to an electronic platform. In our company's history, we have never had a theft of canceled checks that we carry in the form of consolidated cash letters. So from a security standpoint, we do not have that issue of losing checks in transit.

Mr. TIBERI. A good way to end it. Just a note, again to thank Chairman Bachus for having this hearing today. He was pretty excited yesterday about kicking this off and beginning this debate. Let's think of him as he helps his mother in the coming days. I know this issue will be on our plates in the coming weeks and coming months. I really appreciate you all coming out today and spending some time and talking to us about the issue.

The chair notes that some members may have additional questions for this panel, which they may wish to submit in writing.

Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place the response in the record.

This hearing is adjourned. Thank you.

[Whereupon, at 12:53 p.m., the subcommittee was adjourned.]

A P P E N D I X

September 25, 2002

Chairman Michael G. Oxley
Committee on Financial Services

Opening Statement

"Check Clearing for the 21st Century Act" – "Check 21"
Subcommittee on Financial Institutions
September 25, 2002

I want to begin by thanking Chairman Bachus for holding this important hearing on the bipartisan legislation introduced by the gentleman from New Jersey, Mr. Ferguson and the gentleman from Tennessee, Mr. Ford. I would also like to thank the panel of witnesses who have come to testify before the Subcommittee and give their insights into the need for this legislation. In particular, I want to welcome Mr. Lee Schram of NCR based in Dayton, Ohio and Mr. Joe Biggerstaff of AirNet Systems based in Columbus, Ohio. I am looking forward to your thoughts and comments.

When I became Chairman of the Financial Services Committee one of my primary goals was to ensure that U.S. financial institutions had the tools to operate in the most efficient manner possible while maintaining the safety and soundness of the financial system. I believe that we must implement the technological advancements made in the field of payment systems to provide customers with expedited access to capital and credit, while ensuring that they are protected from fraud. The "Check 21" legislation achieves this goal.

Additionally, significant costs savings to customers and financial institutions will be realized with increased electronic check presentment. Too often we are hamstrung in our efforts to provide U.S. businesses and customers with access to the most effective means of dealing with one another.

There is another important reason why this legislation is needed. The terror attacks of last year forced us to reexamine how our country operates under adverse circumstances. This Committee has been at the forefront of the efforts to ensure the integrity of our capital markets, to protect the U.S. money supply, to provide insurance against terror attacks, and with Mr. Ferguson's proposal, to safeguard the U.S. payments system against interruptions in transportation services.

As I anticipate we will hear from several of the witnesses, the days following September 11, 2001 placed the U.S. payments system in crisis when the flights that normally transported checks between banks across the country were grounded. With the enactment of "Check 21" the need for the physical transportation of checks between financial institutions will be reduced and any threat to the transportation system will not affect the presentment of checks in the payments system.

Finally, I would like to thank the Federal Reserve for its hard work in helping to develop H.R. 5414 in consultation with this Committee and other interested parties. I am hopeful that we can achieve broad bipartisan support to move this proposal early next session. I am looking forward to the discussion on this legislation and on future innovations in the U.S. payments system.

Thank you, Mr. Chairman.

9/25/2002

Congressman Harold Ford, Jr.
Financial Institutions Subcommittee
Hearing on HR 5414, the Check Clearing for the 21st Century Act
September 25, 2002

I want to thank Chairman Bachus and Ranking Member Waters for holding today's hearing.

Last week, I joined my colleague from New Jersey, Mr. Ferguson, in introducing the Check Clearing for the 21st Century Act, or "Check 21."

Check 21 builds on the foundation built by the Federal Reserve in its draft Check Truncation Act. In introducing Check 21, Mr. Ferguson and I shared the Fed's stated goals of "facilitating check truncation, fostering innovation in the check collection system without mandating the receipt of checks in electronic form, and improving the overall efficiency of the nation's payments system."

Check 21 seeks to modernize the nation's check payment system by unleashing innovation. In recent years, our financial system has undergone tremendous changes, as technology brings our world closer together and accelerates the pace of progress. Check 21's intent is to bring the benefits of new technologies to more consumers.

Under today's system, millions of paper checks are physically transported every night, by ground and by air. Checks move from the bank to which they are deposited, to any number of intermediary banks, check processors, and/or the Federal Reserve, then are sent to the paying bank, and finally, in some cases, back to the person who wrote the check.

One of the weaknesses in the current system was exposed last September 11th. When the nation's aviation system was grounded in the hours and days after the terrorist attacks, millions of checks could not reach their destination. The nation's payment system ground to a temporary halt. Fortunately, due to the quick response of the Fed, banks all across the nation, and transportation companies including AirNet, which is represented here today, the 9/11 attacks did not cause major disruptions in the financial system.

But the shutdown of the aviation system on 9/11 exposed our check payment system's vulnerability to physical catastrophes -- not only terrorist attacks but natural disasters or other calamity. The subsequent anthrax mailings, which shut down mail delivery in several areas of the nation, highlighted another potential weak link in a system that relies on the physical delivery of paper checks.

The bill that Mr. Ferguson and I have introduced seeks to strengthen our check payment system by fostering check truncation. Through check truncation, paper checks are rendered into digital messages which can move through the payments system at digital speeds.

Check 21 facilitates check truncation without mandating the receipt of checks in electronic form. It does this by establishing a negotiable instrument, a "substitute check," with the same legal status as original checks. These substitute checks would contain an image of the original check, include the magnetic code at the bottom for electronic processing, and conform to standards for size, paper stock, and the like. These substitute checks can be used by banks and consumers in the same way as original checks.

Although we are sensitive to the concerns raised by consumer organizations, including Consumers Union, we believe that Check 21 is a strong pro-consumer bill. Consumers benefit in multiple ways.

First, Check 21 will promote efficiency in the banking system by lessening reliance on the physical transportation and presentation of checks. Consumers will realize these efficiency gains in the forms of lower costs and expedited services.

Second, this streamlined system will reduce the disruptions caused by bad checks. By speeding up the check clearing system, individuals will be notified faster if their check -- or checks written to them -- have not cleared. This will reduce the likelihood that a single bounced check will result in a "chain reaction" of bounced checks.

Third, more customers will be able to benefit from new products and services, such as online access and review of check images. Millions of consumers already enjoy these services, which give consumers instant access to information about their checks, day or night. Also, if a consumer makes an inquiry about a check, his or her bank's customer services representatives will be able to access and review the check instantly. This can sharply reduce the time for customer inquiries. Consumers may also benefit from more deposit options. Because electronic processing could eliminate the need for daily physical pick-up of checks, consumers could enjoy extended deposit cutoff hours or deposit services at remote ATMs.

Finally, Check 21 establishes a new consumer right, an expedited recredit for contested substitute checks. A customer who suffers a loss because a substitute check is charged to their account will receive a recredit within 10 business days, for amounts up to $2,500. This is a new and important consumer protection.

In conclusion, I am proud to have joined Congressman Ferguson in introducing Check 21. I look forward to each of our witnesses' testimony. I am committed to working with each of you on a bill that benefits consumers, improves efficiency, and strengthens our nation's financial system.

September 25, 2002

Opening Statement for Congressman Paul E. Gillmor
House Financial Services Committee Subcommittee on Financial Institutions and Consumer Credit
"The Future of Electronic Checking – Check 21"

I would like to thank Chairman Bachus for holding this important hearing this morning and allowing us to learn industry opinions on this piece of legislation. I am glad to see two witnesses with us here today visiting from my home state of Ohio, Mr. Joe Biggerstaff of AirNet Systems based in Columbus and Mr. Lee Schram of NCR located in Dayton.

As we all observed in the days following September 11th, systems dependent on the movement of time-sensitive materials nationwide must be prepared if the steady flow of air and ground transportation is interrupted.

It is clear that the current check-clearing system in this country is in need of modernization to reduce or end dependence on paper checks that must be physically transported. I am glad to see that the Federal Reserve has already conducted a study on this issue and has expressed their support for increased electronic truncation to bring these procedures into the 21st century.

This morning, I am interested in learning the ability of all parties involved to adapt to this new system within the timeline provided, as not all banks nationwide are currently equipped to accept electronic check transmissions. The substitute check proposal is very important in this regard and I am glad to see it included in the proposal. The needs of small financial institutions must be fully considered throughout this debate.

Again, I look forward to learning the impact this modernization proposal will have on the businesses represented by our witnesses and to an informative dialogue.

Congressman Felix J. Grucci, Jr.
Check Clearing for the 21st Century Act (HR 5414) Hearing
Opening Statement
September 25, 2002

Thank you Mr. Chairman.

First of all I would like to thank Chairman Bachus for holding this hearing today, as well as our 2 panels of witnesses for taking the time to be with us to clarify aspects of the check truncation process and to assist us in developing legislation to further modernize the financial services industry in the United States.

What I am interested in learning today from our panelists is how this proposal would improve the efficiency of financial transactions and most important, how it would benefit the consumer. It is my understanding that current law requires banks to physically present and return original checks. I know that at times – this process can cause serious problems, as demonstrated last September 11th, when planes were grounded and checks could not physically be transported. I can see how an electronic process could avert problems when unforeseen difficulties arise due to weather and disasters. However, I also know from experience that Americans are resistant to change.

I have also been informed that the check truncation process will also decrease the potential for fraudulent activities – however, I am concerned about the potential for fraud in

cyberspace and am interested to hear from our panelists about privacy and security precautions that will be taken.

Additionally I would like to know what kind of an overall, long-term effect this initiative will have on the economy. Will this put the folks who have been transporting checks out of business? Will it save consumers banking fees? Will smaller banks be forced to obtain expensive equipment that large banks might already own, in order to keep up?

I am all for modernizing the financial services system, however, I want to make sure that as we take steps forward, we thoroughly examine the pro's and con's and do the best that we possible can to protect American Consumers.

Thank you Mr. Chairman.

Opening Statement
Congressman Ed Royce (CA-39)
25 September 2002
Check Clearing Act (Check 21) Hearing

Thank you, Chairman Bachus, for holding today's hearing on Congressman Ferguson's proposed legislation, H.R. 5414 -- The Check Clearing for the 21st Century Act. I appreciate the Chairman's efforts to bring attention to this proposed reform, which enjoys a broad base of support from institutions of all sizes throughout the financial services industry.

Under current law, banks are required to present and to return checks physically. To comply with this legal requirement, batches of checks must be transported manually from bank to bank all over the country -- a process which has proven to be both costly and inefficient. This antiquated system of communication between banks is being increasingly left behind as the financial services world becomes more automated and digitized both at home and abroad, and the time has come to bring it up to date.

Congressman Ferguson's proposed legislation builds on a previous Federal Reserve proposal to modernize the nation's check payment system by allowing banks to exchange checks electronically. It also provides the framework for building a new financial infrastructure that is quicker and less susceptible to fraud, while allowing financial institutions of all sizes to serve their consumers with better financial products at a lesser cost.

Finally, by eliminating America's dependence on a check payment system that relies upon transportation networks for its operation, this legislation will help our financial infrastructure to continue to operate smoothly in the wake of a weather crisis, natural disaster or terrorist attack. It is of the utmost importance that America defend its financial infrastructure against the continuing threat of terrorism, and this legislation will put us further down the path toward accomplishing that goal.

I look forward to hearing our witnesses' testimony today about how this legislation will affect both financial institutions and consumers. I also look forward to hearing their opinions on any proposed alterations to this legislation which would make it stronger and help us to achieve the goals of modernizing America's financial infrastructure while increasing its defenses against a terrorism. I thank Chairman Bachus and Chairman Oxley for their leadership and foresight on this issue.

Statement of Representative Brad Sherman
of California
Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services
Hearing on H.R. 5414, the Check Clearing for the 21st Century Act

Mr. Chairman, thank you for holding this important hearing.

As you indicated in your opening statement, one of the impetuses of this legislation was the terror attacks of September 11, 2001, after which our air transportation was grounded, forcing the physical delivery of checks to be conducted "over-the-road." The nation-wide grounding of air transportation delayed the check clearing process.

We should recognize that the delay impacted not only financial institutions clearing checks, but also bill-payers throughout the country who had mailed their bills on time, only to be greeted with late charges on their statements in October 2001. I have a bill, H.R. 3891, to deal with bill payment delays caused by future terrorist attacks and I hope the Chairman will take a careful look at my legislation as we move forward with H.R. 5414.

STATEMENT BY

JOEL BIGGERSTAFF

OF

AIRNET SYSTEMS, INC.

BEFORE THE

HOUSE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

SEPTEMBER 25, 2002

Good morning, Chairman Bachus and ranking member Waters. I appreciate the opportunity to appear before this distinguished Subcommittee in order to testify on proposed legislation known as the "Check Clearing for the 21st Century Act." I am Joel Biggerstaff, CEO of AirNet Systems, Inc., a time-critical shipments air courier headquartered in Columbus, Ohio.

With over 130 aircraft and with Department of Defense certification, AirNet is recognized as an industry leader in the transportation of checks, time-sensitive medical shipments, cargo charter, passenger charter, critical parts and other top-priority deliveries. AirNet employs over 1100 team members with over 300 ground couriers supplementing industry leading door-to-door service.

As a participant in the payments system for some 30 years, AirNet applauds your efforts to improve the overall efficiency of the nation's check clearing system. We are proud of the part our company has always played in ensuring the swift and reliable collection and processing of checks. We estimate that AirNet flies 65% to 70% of all checks that are flown from point to point throughout the nation on a nightly basis. The remaining checks are flown either on the Federal Reserve's Check Relay Network, by large integrators such as UPS or on commercial airlines.

On September 11, 2001, we, like you, were in shock at the news that our country was under attack from the air. The Federal Aviation Administration's (FAA) response, of course, was immediately to ground all aircraft nationwide that morning. This was the one and only time the FAA has ever acted to close domestic national air space (NAS).

Despite the closing of the NAS, however, we at AirNet were called upon to make several flights on September 11 for the American Red Cross under what is known as "lifeguard flight" status. We were in the air at 3:37 that afternoon on the first of four flights that day. The next day, September 12, we flew another eight lifeguard flights while NAS was still closed.

Our banking customers, of course, still had checks to move. To solve that challenge, we put into place a massive ground operation to cover as much territory as possible for our bank customers while NAS was closed.

On September 13, with the re-opening of NAS scheduled for that evening, AirNet received a call from the Federal Reserve. The Federal Reserve was requesting our assistance to coordinate the massive movement of checks that had been awaiting processing since the 11th. We were happy to respond. In fact, Mr. Chairman, we were in contact with this Committee during that time to advise of our ongoing work plans and to seek logistical assistance with the Department of Treasury in clearing our aircraft.

On the evening of the 12th, AirNet helped move over 500,000 pounds of checks (5 times the normal amount transported on a typical night) and moved another 275,000 pounds later that weekend. One letter of thanks from a customer illustrates the quality of our performance:

"On behalf of Float Management at Bank of America, I would like to express our sincere thanks for your dedication to service during the recent tragedy. Your commitment to your customers has always been evident in your customer service and delivery quality, but recent events have proved

your competent staff to be exceptional....Thank you again for your dedication to keeping the payment system 'moving.' " -- Tracy Haynes, Sr. VP, Bank of America.

With your permission, Mr. Chairman, we would like to offer for the record a number of similar commendations from our customers and from the Red Cross.

The FAA took the right and necessary decision on September 11. It was essential that NAS be closed. However, with all due respect to some in support of the measure being considered, reducing the impact of air service disruption to the payments system does not require the passage of new legislation. The impact of this disruption could have been significantly reduced and perhaps completely avoided had the transportation of checks in the payments system been given "lifeguard" status.

The electronic transmission of check images is no guarantee of uninterrupted check processing. Electronic systems are much more sensitive to disruption than air transportation and, indeed, cyber-terrorism is perhaps one of the greatest threats we now face. Moreover, even with passage of the Check Clearing for the 21st Century Act, truncation would not be mandatory and air transportation would continue to be crucial. Should events in the future ever cause the closing of NAS again, the air transportation of checks can be guaranteed by the simple designation of "lifeguard status" to these critical shipments.

The electronic transmission of check information, side-by-side with air transportation, represents a fundamental principle of safe and sound banking: redundancy. The full functioning of these two methods of check processing ensures the long-term integrity of the payments system. Indeed, a policy that dismantles the air transportation infrastructure could represent a threat to the integrity of the payments system.

In this regard, the Federal Reserve, along with other agencies, recently requested comment on a draft White Paper entitled "Sound Practices to Strengthen the Resilience of the U.S. Financial System." The White Paper refers to "core clearing and settlement organizations" which it defines as "firms that provide ... critical clearing and settlement services for critical financial markets in sufficient volume or value to present systemic risk in their sudden absence, and for whom there are no viable immediate substitutes."[1]

The events of last September illustrate that AirNet is a "core clearing and settlement organization." Its ability to operate was and is essential to the functioning of the U.S Financial System. We therefore urge that this Subcommittee, during future deliberations on this legislation, seriously consider conferring lifeguard status for air transportation activities associated with the payments system.

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[1]Draft Interagency White Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System, Board of Governors of the Federal Reserve System [Docket No. R-1128], p. 5.

Mr. Chairman, by supporting the lifeguard designation for the payments system, by supporting a policy to protect redundancy in check processing infrastructure, and by supporting transportation as a core clearing function, you will promote and improve the overall efficiency of the payments system, which is the stated goal of this legislation.

Approximately two years ago, Federal Reserve Chairman Alan Greenspan, in remarks delivered to NACHA, described check truncation as a notable electronic payment "experiment" that warranted careful attention. Today, this Subcommittee is being presented legislation seeking to codify this "experiment" in response to an effort by a few in the banking industry who stand to benefit mightily from its enactment.

But is this legislation really necessary? We respect the Federal Reserve's desire to speed the movement away from paper checks to electronic transactions. Yet, we would observe that the Federal Reserve's own recent Study[2] of check volume shows that the use of paper checks has dropped dramatically in recent years, much more than the banking industry had previously thought. A slighter newer study by the same consulting firm that assisted the Fed in 2001 concluded that about 42 billion checks were written in 2001. The 2001 Study had reported approximately 50 billion checks were written in 2000, which was itself startling since the industry-wide assumption had placed the check volume figure at 68 billion.

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[2] *Depository Financial Institution Check Study*, published in the August 2002 Federal Reserve Bulletin.

The most recent study found that check volumes declined by 2% from 2000 to 2001. It also found that 67% of the financial institutions surveyed reported a decline in the average daily volume of paper checks processed. It thus appears that paper checks will gradually be eliminated in favor of electronic forms of payment, without Congressional intervention.

Is it wise, in seeking to increase the number of checks that are truncated, to adopt a contorted solution that introduces many unknowns into the check collection process when, in fact, the volume of paper checks is dropping through natural evolution?

Our purpose in testifying today is not to pass judgment on the specifics of this proposed legislation. We do, however, urge this Subcommittee to examine the details of this proposal carefully and to analyze the collateral impact of its provisions. We look forward to a robust discussion within the Subcommittee of these important issues.

Thank you, Mr. Chairman, for the opportunity to testify and I would be pleased to answer any questions you or the members of the Subcommittee may have.

STATEMENT OF

ROBERT M. FENNER

GENERAL COUNSEL

NATIONAL CREDIT UNION ADMINISTRATION

ON THE

"CHECK CLEARING FOR THE 21ST CENTURY ACT"

BEFORE THE FINANCIAL SERVICES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

U.S. HOUSE OF REPRESENTATIVES

SEPTEMBER 25, 2002

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.

For release on delivery
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Statement of

Roger W. Ferguson, Jr.

Vice Chairman

Board of Governors of the Federal Reserve System

before the

Subcommittee on Financial Institutions and Consumer Credit

Committee on Financial Services

U.S. House of Representatives

September 25, 2002

I would like to thank the subcommittee for inviting me to discuss H.R. 5414, the proposed Check Clearing for the 21st Century Act. This bill, which is similar to a proposal the Board sent to Congress late last year, removes existing legal barriers to the use of new technology in check processing and holds the promise of a more efficient check collection system. The Board commends Representatives Ferguson and Ford for introducing this bill.

Technological Advances in Check Processing

Check processing is far more efficient than it once was. Less than fifty years ago, clerks hand sorted millions of checks each day. In the 1960s, the banking industry began to use mechanical high-speed check processing equipment to read and sort checks, which had been redesigned for automated processing. Today, banks, thrifts, and credit unions, which I will collectively refer to as banks, process the more than 40 billion checks that consumers, businesses, and the government write each year.

Legal impediments, however, have prevented the banking industry from fully using these new electronic technologies, such as digital imaging, to improve check processing efficiency and provide improved services to customers. This is because existing law requires that the original paper checks be presented for payment unless the banks involved agree otherwise. We can see how this requirement constrains technological adoption by following a check through the collection process. After a bank's customer deposits a check with his or her bank, the bank typically transports the check from the branch or ATM where it was deposited to a central operations center. The check is then usually sent to one or more intermediaries – such as a Federal Reserve Bank or a correspondent bank – or a clearinghouse for collection before it is ultimately delivered to the bank on which it is drawn for payment. During each step of this process, the check must be physically shipped to its destination by air or ground transportation.

Of course, banks can agree to accept checks electronically, but the large number of banks in the United States makes it infeasible for any one bank to obtain such agreements from all other banks or even a large proportion of them. Therefore, legal changes are needed to facilitate the use of technologies that could improve check processing efficiency, which should lead to substantial reductions in transportation and other check processing costs. H.R. 5414 makes such changes.

Proposed Check Clearing for the 21st Century Act

The proposed Check Clearing for the 21st Century Act solves a longstanding dilemma – how to foster check truncation early in the check collection or return process without mandating that banks accept checks in electronic form. The term check truncation refers to any of a number of arrangements in which the original paper checks are removed from the collection or return process. Currently, under typical check truncation arrangements, electronic information about a truncated check is presented to the bank on which it is drawn rather than the original paper check. The act facilitates check truncation by creating a new negotiable instrument called a substitute check, which would permit banks to truncate the original checks, to process the check information electronically, and to deliver substitute checks to banks that want to continue receiving paper checks.

A substitute check, which would be the legal equivalent of the original check, would include all the information contained on the original check – that is, an image of the front and back of the original check as well as the machine-readable numbers that appear on the bottom of the check. Under this act, while a bank could no longer demand to receive the original check, it could still demand to receive a paper check. Banks would likely receive a mix of original checks and substitute checks. Because substitute checks could be processed just like original checks, a

bank would not need to invest in any new technology or otherwise change its current check processing operations.

Banks could use the new authority provided in this legislation in a number of different ways. For example, a bank would no longer need to send couriers every afternoon to each of its branches and ATMs to pick up checks that customers have deposited. Instead, digital images of checks could be transmitted electronically from those locations to the bank's operations center for processing. Not only would this be quicker and more efficient, but it could permit banks to establish branches or ATMs in more remote locations and to provide later deposit cut-off hours to their customers.

Moreover, the act would give a bank the flexibility to transmit checks electronically over long distances, and create substitute checks at locations near their ultimate destination, for example to the bank on which the checks are drawn, substantially reducing the time and cost associated with physical transportation. By enabling the banking industry to reduce its reliance on physical transportation, the proposed act would also reduce the risk that checks may be lost or delayed in transit. Today, bad weather routinely delays check shipments and there have been occasions when checks have been destroyed in plane crashes. The banking industry's extensive reliance on air transportation was underscored in the aftermath of the September 11 tragedy, when air transportation came to a standstill and the flow of checks slowed dramatically. During the week of the attacks, the Federal Reserve Banks' daily check float, which is normally a few hundred million dollars, ballooned to more than $47 billion. Had the proposed legislation been in effect at that time and had banks been using a robust electronic infrastructure for check collection, banks would have been able to collect many more checks by transmitting electronic check information across the country and presenting substitute checks to paying banks.

Finally, many banks hope to use the authority provided by this legislation to streamline the processing of checks that they must return unpaid. Today, after a bank processes its incoming checks and determines which checks to return, it has to reprocess all of the incoming checks to pull out the less than one percent of checks that are to be returned unpaid. Many banks have indicated to us that they would find it more cost effective to use their image systems to generate substitute checks for return rather than to outsort the returned checks from all the checks presented.

The act might also better position banks to provide new and improved services to their customers. For example, banks might allow some corporate customers to transmit their deposits electronically. Because the act will likely encourage greater investments in image technology, banks might also be able to expand their customers' access to enhanced account information and check images through the Internet. In addition, banks might be able to resolve customer inquiries more easily and quickly than today by accessing check images.

The act is designed to provide banks with additional flexibility in processing checks by requiring banks to accept substitute checks in place of original checks. The act does not, however, require banks to accept checks in electronic form nor does it require banks to use the new authority granted by the act to create substitute checks. This market-based approach permits each bank to decide whether to make use of this new authority. This decision will be based on the bank's internal business case analysis, which will assess the costs and benefits of using the new authority.

We believe the market changes arising from these revisions to check law will result in substantial cost savings. Clearly, because substitute checks can be processed in the same manner as original checks, recipients of substitute checks should incur little or no additional processing

costs. Recipients, however, will incur some additional costs relating to the act's customer protection and disclosure requirements. It is difficult, however, to estimate the overall cost savings. Different banks will take different approaches toward using the new authority granted by the act. Each bank's use of the new authority will depend on its technology infrastructure and strategy, its physical infrastructure, and its customer and business profiles. Thus, the magnitude of the cost savings, which will depend on the rate at which banks begin using the new authority, is difficult to determine.

We recognize that the most challenging policy issue in the proposed law, and the aspect of this legislation that has generated the most spirited discussion, relates to customer protections. Current check law protects customers if there is an unauthorized debit to their accounts. A customer already has a claim against its bank for an unauthorized charge, and the bank may be liable for interest on the amount of the unauthorized charge and consequential damages for the wrongful dishonor of any subsequently presented checks.[1] The proposed legislation applies these existing protections to substitute checks. There are, however, differing views as to whether additional customer protections are necessary for substitute checks and, if so, how extensive those protections should be. We believe that, in determining the form these protections should take, the associated benefits and costs will need to be carefully balanced.

Federal Reserve Board Authority to Regulate the Payments System

We understand that there is some debate regarding whether the Federal Reserve Board already has sufficient statutory authority to adopt by regulation the concepts embodied in this proposed legislation. Although Congress has given the Board authority to regulate the check system and other aspects of the payments system, we do not believe that this authority is sufficiently broad to enable us to adopt regulations that accomplish the purposes of the act.

In the 1987 Expedited Funds Availability Act (EFAA), Congress gave the Board broad authority to regulate "any aspect of the payment system, including the receipt, payment, collection, or clearing of checks; and any related function of the payment system with respect to checks" in order to carry out the EFAA.[2] The EFAA also provides that the Board's regulations supersede any inconsistent provision in state law, including the Uniform Commercial Code.[3] In the EFAA, Congress directed the Board to consider requiring, by regulation, a number of measures to improve the check system.[4] Many of these measures focused on improving the process by which unpaid checks are returned to the bank of first deposit. Other suggested measures related to check truncation.

The Board has used its authority under the EFAA to make several important improvements to the check system.[5] The Board's ability to adopt some rules to improve the check system is hampered, however, by the EFAA's limitation on the Board's ability to impose or allocate the risks of loss or liability related to payment transactions.[6] The EFAA authorizes the Board to impose on or allocate among only depository institutions the risks of loss or liability, and only up to the amount of the check giving rise to the loss or liability, except where there is bad faith. These limitations have prevented the Board from adopting by regulation some

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[1] U.C.C. §4-401(a) and §4-402
[2] 12 U.S.C. §4008(c)
[3] 12 U.S.C. §4007(b)
[4] 12 U.S.C. §4008(b)
[5] The Board has adopted rules that substantially revise the process by which banks return unpaid checks, which has expedited the receipt of those checks by depositary banks and ensured prompt notice of large-dollar returned checks. In addition, the Board has adopted rules that enhance the legal abilities of private-sector banks to obtain same-day final settlement for checks presented by a specified time, which has spurred competition in the provision of check clearing services, improved efficiency, and sped the collection of many checks.
[6] Section 611(f) of the EFAA states "The Board is authorized to impose on or allocate among depository institutions the risks of loss and liability in connection with any aspect of the payment system, including the receipt, payment, collection, or clearing of checks, and any related function of the payment system with respect to checks. Liability under this subsection shall not exceed the amount of the check giving rise to the loss or liability, and, where there is bad faith, other damages, if any, suffered as a proximate consequence of any act or omission giving rise to the loss or liability." [12 U.S.C. §4010(f)]

important innovations that could substantially improve the efficiency of the check system. For example, the Board cannot adopt by regulation the changes called for in the proposed Check Clearing for the 21st Century Act, because the bill affects the rights of the end users of checks (including businesses and consumers), in particular their right to receive their original checks, and allocates liability for not only the amount of the check but also interest, litigation costs, and in some cases consequential damages.

Conclusion

In conclusion, although an increasing number of payments are being made electronically, it is clear that checks will continue to play an important role in the nation's payments system for the foreseeable future. We believe that, over the long run, the concepts embodied in the proposed Check Clearing for the 21st Century Act will spur the use of new technologies to improve the efficiency of the nation's check collection system and provide better services to bank customers. Because the act should result in substantial cost savings, it would also be desirable to begin obtaining these savings in the near future, ideally before the bill's proposed 2006 effective date.

There are some technical matters in the current version of the bill that could be improved or clarified, and we look forward to working with the Committee as it further considers this legislation. Thank you for your time and I would be happy to answer your questions.

Testimony of

America's Community Bankers
American Bankers Association
Consumer Bankers Association
The Financial Services Roundtable
Independent Community Bankers of America

on

Check Clearing for the 21st Century Act

before the

Subcommittee on Financial Institutions
and Consumer Credit

of the

Financial Services Committee

of the

United States House of Representatives

on

September 25, 2002

Curtis L. Hage
Chairman and CEO
Home Federal Bank
Sioux Falls, South Dakota

and

Chairman
America's Community Bankers
Washington, DC

I am Curtis L. Hage, chairman and CEO of Home Federal Bank in Sioux Falls, South Dakota. Home Federal is a $720 million institution headquartered in South Dakota with 32 branches in South Dakota and an additional branch in Minnesota. I also currently serve as Chairman of America's Community Bankers. I am here today representing the five major banking and financial services trade associations — America's Community Bankers, the American Bankers Association, the Consumer Bankers Association, the Financial Services Roundtable, and the Independent Community Bankers of America (the "banking and financial services trade associations").

I am pleased to present the banking and financial services trade associations' views on the proposed Check Clearing for the 21st Century Act ("the Check Clearing Act"). It is somewhat exceptional when all the banking and financial trade associations are in agreement on any topic. However, on this issue the associations are united in supporting efforts to increase the efficiency of the nation's payments system. We believe that by providing financial institutions with clear authority to use substitute checks to reach banks and customers not currently participating in check image programs, Congress can help drive significant cost savings and efficiencies that will benefit both consumers and financial institutions.

On behalf of the banking and financial trade associations, I would like to extend our appreciation to both Chairman Bachus for holding this hearing, as well as to Congressman Ferguson and Congressman Ford for introducing this legislation. Our appreciation also extends to the outstanding efforts of the staff of the House Financial Services Committee and the Federal Reserve Board ("Board") who worked tirelessly to address the concerns of the banking industry, consumer groups, and others in moving this proposal forward.

Consumer Payment Alternatives and the Check Clearing Process

Typical consumers have a variety of alternatives at their disposal to make non-cash retail payments including debit cards, credit cards, ACH debit as well as traditional checks. According to the Board, American consumers make more than 70 billion of these non-cash retail payments each year. And while the number of electronic payments represents an increasing number of these non-cash payments, traditional paper checks remain the dominant form of non-cash payment in the U.S. today. Despite repeated prediction of their demise, checks play a significant role in the U.S. payments system, and will continue to do so for years to come.

The processing of checks is an enormously expensive and labor-intensive process that requires the handling, sorting, and physical transportation of checks to payor banks. Current law generally requires physical checks to move through the entire clearing process from the bank of first deposit to the payor bank. To clear checks electronically, banks must negotiate an agreement that permits the processing of checks without the original paper check. Since the benefits of electronic processing are not shared equally among the participants, these agreements are most often found between very large institutions with massive check processing volume.

While physical checks continue to move through the clearing process, an increasing number of consumers do not have their original checks returned to them. Informal industry assessments estimate that more than 30 percent of all checks drawn by bank customers, and nearly all checks drawn by credit union customers are not returned to the check writer. Through a variety of safekeeping strategies, many consumers, rather than receive their original check, receive detailed information about their

check transactions in their monthly account statement. Some customers also receive images of canceled checks, or have the ability to access check images online. Those who do not automatically receive check images can request a copy from their bank. Detailed check transaction information and check images satisfy virtually all customer needs (e.g., proof of payment, tax records, etc.) and original items are rarely requested or needed.

The removal, or truncation, of paper checks from clearing, processing, and settlement activities is growing and will continue to grow regardless of whether the Act is passed. However, passage of the Check Clearing Act will facilitate and advance the orderly movement toward electronic processing which provides benefits to all participants.

Improving the Efficiency of the Check System

Responding to the massive costs and inefficiencies associated with check processing, the Board's Payments System Development Committee actively sought input from the banking industry, consumer groups, check clearinghouses, processors, and others in developing a proposed legal framework intended to remove the barriers to the wide scale use of electronic truncation. The Fed's efforts served as the foundation for the Check Clearing Act proposed by Congressmen Ferguson Ford.

The Proposed Check Clearing Act for the 21st Century

The Check Clearing Act would allow a collecting bank to remove, or truncate, the original paper check from the check collection or return process. The proposal would enable the entire banking industry to use electronic images to process and clear checks. For those banks that choose to process paper checks, the proposal allows for the creation of a "substitute check" that would retain the legal equivalence of the original check. It is important to note that under the Check Clearing Act, substitute checks must adhere to rigorous standards that ensure the document accurately represents the original check and can be processed in the same manner as the original check.

Under the Check Clearing Act, no longer would a California bank have to ship a check drawn on a New York bank across the country for clearing, processing and settlement. Substitute checks could be processed and transmitted electronically in lieu of the original paper check. Most importantly, the proposal does not require the banking industry to adopt a fully electronic check clearing system; rather it provides the industry with the flexibility to adapt to electronic check clearing over time without interfering with the existing paper check process.

The banking and financial services trade associations believe that removing the legal impediments to the expanded use of electronics for check clearing and settlement will improve the efficiency of our nation's payments system and provide benefits to consumers as well as banks. Expanding the use of electronics in check processing will help streamline the collection and return of checks, reduce processing costs, and minimize the effect of unexpected disruptions to air and ground transportation systems. Moreover, reducing the dependency on the physical presentment of original items will result in faster check collection, provide information about transactions to consumers more rapidly, make funds available sooner, and help combat fraud.

Improving the check clearing process may also allow banks to develop new and more flexible banking services. For example, new image-capable ATMs may make it possible for banks to offer extended deposit cutoff at remote locations since the need for physical same-day pick up could be eliminated.

This technology could also make it possible for banks to deploy more ATMs in remote locations as the cost of retrieving deposits and servicing ATMs could be reduced.

Benefits of Check Truncation and Imaging

In addition to the direct impact on costs, the Act would serve to promote imaging technology that can help speed processing and improve service to customers. Many consumers are already enjoying the benefits and conveniences associated with check imaging. Rather than dealing with bundles of canceled checks, consumers are able to receive concise and convenient summaries of their transactions in order to reconcile their accounts. These benefits go beyond simple consumer conveniences. The ability to access check images on the Internet helps consumers to quickly and conveniently verify their transactions, identify potential errors, and detect fraudulent transactions sooner by reviewing check images on-line. Identifying errors and potential fraud as soon as possible helps banks minimize customer inconvenience, control potential losses, and gives law enforcement an advantage in tracking down perpetrators.

Imaging also benefits those less tech-savvy consumers by empowering customer service representatives with immediate access to check images in order to respond to customer inquires, or to provide copies checks instantaneously. Accessing images of checks takes a fraction of the time required in microfilm or physical archives. No longer will customers have to wait for a copy of their check to be obtained from a central processing facility or microfiche library. Today, institutions that have implemented check imaging offer customers a wide variety of ways to access these images, including in person at branches, through the mail, over the Internet, in image-statements and at advanced ATMs.

Finally, it's important to note that the Check Clearing Act could provide real benefits to rural community banks and their customers. In South Dakota we are constantly challenged to meet our federally mandated funds availability deadlines due to adverse weather conditions and limited access to air courier services. For example, one Home Federal branch provides financial services for a remote part of the state that is nearly five hours away via ground transportation to a central processing facility. No air courier is available, and every banking day we courier items from this branch to our central processing facility in Sioux Falls. Customers of this branch are subject to the earliest possible deposit deadline allowed under regulations, and we frequently end up having barely enough time to process items within federal funds availability time limits. Additionally, the limited competition for courier services in remote areas means that Home Federal customers pay a premium for moving checks across the state. The Check Clearing Act would allow Home Federal and other rural community banks to transmit electronic images of checks that can be used for clearing and settlement with our existing systems.

One Community Bank's Experience

Some critics of this legislation have expressed concern over relying too heavily on check images. The experiences of my institution and of many others who have been offering check safekeeping services for a number of years demonstrate that these concerns are unfounded.

Home Federal began offering checking accounts around 1980, and from the beginning we provided customers with the convenience of check safekeeping. Home Federal customers receive detailed information about checks drawn on their accounts, while the original physical check is microfilmed and stored for a period of time at our check processing facility. Safekeeping programs benefit both

consumers and banks. Consumers receive a convenient summary of transactions in order to reconcile their account, and avoid the burden of receiving and storing reams of canceled checks. Banks in turn reduce mailing and handling costs. These savings can be passed on to consumers in the form of more competitively priced products and services.

About seven years ago in response to the demands of customers from an acquired institution and other competitive pressures, Home Federal began offering the option of having checks returned with statements for a very nominal fee. Today, Home Federal processes more than a half million check items every month for our 25,000 checking account customers, with more than 90 percent of our customers choosing not to have checks returned. Later this fall, Home Federal will begin providing full image statements of processed checks to customers and online access to images as part of our Internet banking services. We expect that once these image products are available, that almost all of our customers will choose not to have their original checks returned.

Existing Consumer Protections for Checks are Adequate

The banking and financial services trade associations support the concepts outlined in the proposed Check Clearing Act. The legislation effectively removes the dependency on the physical presentment of original checks without mandating receipt of checks in electronic form. We believe that the protections provided to consumers under existing check law provide adequate protection for the substitute checks authorized under the proposed legislation.

The banking industry and consumers have an established history of dealing with truncated checks and image documents. The millions of consumers who agree to receive their return checks in the form of images or other electronic representations demonstrate that existing law provides adequate protections. There is no evidence to suggest any significant consumer issues relating to the receipt of images or electronic representations of return check items.

Under the Uniform Commercial Code, a bank is liable to its customer if it charges its customer's account for a check that is not "properly payable." This includes checks that are not authorized by the consumer, checks containing a fraudulent endorsement or signature, and other erroneously posted checks. A bank that improperly debits a customer's account is liable to the customer not only for the amount of the improper debit, but also for the amount of any damages that are caused by any checks that are returned due to insufficient funds resulting from the improper debit. Additional protections and funds availability schedules are provided under Federal Reserve Board Regulation CC. For example, under Regulation CC returning banks warrant to the bank customer to whom the check is being returned that they have returned the check in accordance with the requirements of applicable law, that they are authorized to return the check, and that the check has not been materially altered.

Proposed Expedited Recredit Provisions Unnecessary and Could Cause Problems

The proposed Check Clearing Act establishes a complicated expedited recredit and reversal of recredit structure for consumers and banks. Under the proposal, a consumer who suffers a loss because a substitute check was charged to their account is entitled under certain circumstances to receive recredit of up to $2,500 within 10 days of the claim. The banking and financial services trade associations believe this provision is unnecessary and may result in unintended consequences. Today, banks respond to customer claims of check fraud or processing errors in a timely and effective manner. Complaints are rare. In fact, Board staff has indicated that an informal review of the consumer

complaints filed with all the banking regulatory agencies reveal no significant consumer issues relating to existing check protections or checks generally, whether truncated or not. Complicated new recredit procedures would only serve to confuse customers, create compliance headaches for banks, and expose banks to potential new sophisticated fraud schemes.

In addition to the banking and financial trade associations' concern over the proposed expedited recredit provisions, we also believe the proposed effective date of January 1, 2006 may be too lengthy. The original Board proposal suggested a one-year effective date from time of enactment. We respectfully request that the committee carefully consider whether a shorter effective date may be more appropriate.

Conclusion

The banking and financial services trade associations support the general principles outlined in the Check Clearing Act to facilitate innovation in the check collection system without mandating receipt of checks in electronic form. We believe, however, that the body of law and regulation developed around existing check clearing processes is both effective at protecting consumers and minimizing the banking industry's exposure to fraud. The banking industry and consumer experience with existing check safekeeping and truncation programs demonstrate that existing law and regulations work. We urge members of the committee to consider changes to the legislation that will preserve existing law with respect to substitute checks authorized under this proposal. We urge members of Congress to take this opportunity to help improve the efficiency of the U.S. payments system universally supported by the banking industry and the Federal Reserve Board.

Represented Organizations

America's Community Bankers:
America's Community Bankers represents the nation's community banks of all charter types and sizes. ACB members, whose aggregate assets exceed $1 trillion, pursue progressive, entrepreneurial and service-oriented strategies in providing financial services to benefit their customers and communities.

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.

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 financial services, including auto finance, home equity lending, card products, education loans, small business services, community development, investments, deposits and delivery.

CBA was founded in 1919 and provides leadership, education, research and federal representation on retail banking issues such as privacy, fair lending, and consumer protection legislation/regulation. CBA members include most of the nation's largest bank holding companies as well as regional and super community banks that collectively hold two-thirds of the industry's total assets.

The 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.

Independent Community Bankers of America
ICBA is the nation's leading voice for community banks and the only national trade association dedicated exclusively to protecting the interests of the community banking industry. We aggregate the power of our members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.

ICBA has 5,000 members with branches in 17,000 locations nationwide. Our members hold nearly $511 billion in insured deposits, $624 billion in assets and more than $391 billion in loans for consumers, small businesses, and farms in the communities they serve. ICBA members employ more than 231,000 people.

Testimony

of

Gail Hillebrand
Senior Attorney,
West Coast Regional Office,
Consumers Union of U.S.

before the

United States House of Representatives
Financial Services Committee

September 25, 2002

On the Check Clearing for the 21st Century Act

Other organizations joining in this testimon

Consumer Federation of America

U.S. PIRG

National Consumer Law Center

West Coast Regional Office
1535 Mission Street San Francisco, CA 94103
(415) 431-6747 • **fax** (415) 431-0906 • http:/www.consumersunion.org

This testimony is presented by Gail Hillebrand, a Senior Attorney at the West Coast Regional Office of Consumers Union. Consumers Union is the nonprofit publisher of *Consumer Reports*. Consumers Union's mission is to Test, Inform, and Protect, and it offers this testimony as part of the consumer protection function. Joining in this testimony is the Consumer Federation of America, the U.S. Public Interest Research Group, and the National Consumer Law Center.[1]

These national consumer organizations oppose both the Federal Reserve's proposed Check Truncation Act (CTA) and the September 19, 2002 Check Clearing for the 21st Century Act. The Check Clearing Act appears to be based on the CTA, but the Check Clearing Act is significantly worse for consumers than the Federal Reserve's CTA, because it offers a far weaker right of recredit when there is a dispute about payment of a check. The discussion in this testimony applies to both versions of the Act, except where noted.

These national consumer organizations oppose both versions of this Act for these reasons:

- The Act would make it impossible for the estimated 45.8 million U.S. households who now get their paper checks back to get all their paper checks back every month.
- The Act does not effectively protect consumers from new errors that could be caused by electronic imaging of checks.
- The one new consumer right offered by the Act does not apply to all consumers whose checks will be affected. In addition, that new right could be easily eliminated by a bank through a simple change in the account agreement.
- Particularly in the Check Clearing Act form, the Act gives consumers who write checks which are turned into electronic images weaker rights than consumers who initiate electronic funds transfers.
- Th Act gives no right to get back the original paper check if it is needed for a reason other than an error in payment.
- Information on the electronic image of a check could be used to invade consumer privacy.
- The Act does not protect against high fees when the consumer needs to request the original check or a so-called "substitute check."
- The Act does not require banks to credit the depositor's account more quickly if electronic imaging of checks speeds up check clearing.

[1] Each of the groups submitting this testimony is described at the end of this testimony.

Congress Should Not Destroy Consumers' Ability to Get Our Checks Back

If Congress adopts the Act, it will destroy the ability of millions of U.S. consumers to get back and keep their original paper checks. At an August 2002 meeting, bank representatives stated that approximately 60% of consumers east of the Mississippi River, and 30% of consumers in the West, receive their original checks back. Since approximately 90% of the 105 million U.S. households have a bank account, usually a checking account, this means that approximately 45.8 million U.S. households get back their paper checks. Indeed, some consumers want their checks back so much that they are willing to pay a fee, often $1 per month, to receive them.

The Act will make it impossible for consumers to regularly receive back original paper checks, because the consumer's bank will no longer receive the original paper check in the ordinary course of business. Instead, the consumer's bank will receive either an electronic image of the paper check, or a paper "substitute check." The substitute check is a paper item made from an electronic image of the check. The consumer's original check may be at some other bank in the check collection process, and that bank is free to destroy it.

The Act would also change the system for consumers who don't get their checks back now. Today, consumers who agree not to get their checks back can still request the original check from their own bank, which can provide it if it hasn't yet been destroyed. Under the Act, the original check would never be sent back to the check writer's bank. So, a consumer who asks his or her bank for an original check back would have to wait longer while the consumer's bank tries to determine which bank in the check collection chain has the original check.

Banks are allowed to destroy original checks not returned to consumers now, but a consumer can shop for an account with returned checks, or for an account where the bank promises to keep the original checks for a designated time. This would be impossible under the Act. Because the consumer's bank won't have the original checks, it won't be able to promise to keep those checks for a customer.

What the Check Clearing Act and its Predecessor, the Federal Reserve Board's Check Truncation Act, Would Do and How They Would Increase Practical Problems for Consumers

Approximately ninety percent of consumers have checking accounts. Over 35 billion checks a year are written on U.S. banks. Both the Check Clearing Act and the Check Truncation Act would fundamentally change the way checks are processed, making it impossible for consumers and businesses alike to get their original checks returned with checking account statements each month.

Each Act would encourage check truncation, the practice of stopping or "truncating," the movement of the check somewhere in the check collection process. The original check would no longer be sent back to the consumer or to the consumer's bank. Consumers, businesses, and banks who desire original checks would instead be given a paper copy of an electronic image of the original check. This paper copy of the electronic image is called a "substitute check."

The substitute check would show all of the information on the front and back of the original check, but it would not show things that can't be copied, such as the pressure applied to the pen by a forger. The substitute check would be legally equivalent to the original check if it contains the required information. The Act places no limit on what banks could charge for a substitute check. The Act also doesn't require that the original check be returned to the consumer on request. Instead, because the Act makes a "substitute check" legally equivalent to the original check, a consumer who asks for the original check might by told by his or her bank, "all we will give you is this paper substitute check." It will be up to the consumer to persuade a landlord or another person to accept the substitute check as proof of payment. The practical inconvenience will fall on the consumer, since many persons to whom consumers have to prove payment won't know that under the new law the substitute check is supposed to prove payment to the same extent as the original check.

The Federal Reserve Board suggests that consumers will be no worse off, because consumers who get their checks back now will get substitute checks instead, and the Fed's proposal would give these consumers a one day right of recredit if they claim a check was improperly paid. However, the Check Clearing Act provides for a recredit after ten business days, not one business day. In addition, under both versions of the Act, consumers with voluntary check truncation won't get the recredit right. Banks can insist on a truncation agreement that takes away the right to receive any paper with the account statement, even paper "substitute checks." Consumers whose accounts are governed by a truncation agreement and receive back no paper also will not receive the right of recredit.

Consumers with account agreements calling for non-return of checks or for return only of printed or online check images but not substitute checks would not receive the one day right of recredit. Instead, those consumers could wait weeks or months to get their funds returned, since neither the Act nor state law places a time limit on how long a bank can take to resolve a dispute about a check which is not a substitute check.

If the consumer alleges that a check was improperly paid, such as paid twice or paid for the wrong amount, then the consumer who got back a substitute check is entitled, under both the Check Clearing Act and the Fed's CTA draft, to a recredit of funds, but the recredit right is weak under both versions, and there are additional flaws in the Check Clearing Act version.

If a consumer needs the check for a reason other than a claim that it was improperly charged to the consumer's account, such as to show it to a landlord or other person

who refuses to accept the substitute check as proof of payment, the Act does not give that consumer any right to ever receive the original check. If a bank does track down the original check on request as a customer service, the Act places no limit on what the bank can charge for finding and returning the check. Even if a particular bank decides, as a matter of customer service, not to charge for returning a single original consumer check on request, a bank further up the collection chain which is holding that check might decide to impose a fee for returning it.

The Act also places no limit on what a bank can charge for regular return of so-called "substitute checks," paper copies made from the electronic check images.

Why Change a Working System?

We estimate that 45.8 million U.S. households now get their paper checks back. The Act would force all of those households to change the way that they manage their finances. The current check system works for consumers, with some exceptions. Not everyone can get a checking account, in part because prior difficulties in managing an account can prevent a consumer from getting an account for up to seven years. The types of fees associated with checking accounts have expanded, and some types of fees have risen rapidly.[2] The Act does not fix any of these ongoing consumer problems with checking accounts.

Why Give Consumers Who Write Checks that Are Changed Into Electronic Images Weaker Rights than Consumers Have Under Regulation E for Other Electronic Payments?

Today, consumers with a checking account and a debit card can choose between writing a paper check and paying electronically. The Act allows banks to treat a check more like an electronic funds transfer, but it doesn't give all consumers who write checks protections of the type that apply to an electronic funds transfer. There are two key differences. First, all consumers who initiate electronic funds transfers get a right to recredit of funds after a set time period, while the Check Clearing Act and the Fed's CTA proposal give a recredit right only to consumers who receive substitute checks, not to consumers whose checks are voluntarily truncated. Second, the Federal Reserve Board's CTA adopted a shorter, one business day, recredit time period than Regulation E, and offset this shorter time period with a $2,500 dollar cap on the amount of the recredit. However, the Check Clearing Act chooses a longer, ten business day, time

[2] For example, the monthly fee for a low balance, single-fee bank checking account went from $6.34 in 1996 to $7.12 in 2001 (a 12.3% increase), Depository institutions', including banks', fees for overdrafts rose over the same time period from $16.28 to $20.42 (a 25.4% increase), for NSF items from $16.36 to $20.73 (a 26.7% increase), and for stop payment orders from $13.68 to $18.08 (a 32.2% increase). Board of Governors of the Federal Reserve Board, *Annual Report to the Congress on Retail Fees and Services*, June 2002; B). Board of Governors of the Federal Reserve Board, *Annual Report to the Congress on Retail Fees and Services*, June 1998.

period but keeps the dollar cap, thus making the consumer remedy weaker for electronically imaged checks than for electronic funds transfers.

There is No Guarantee that Consumers Will Benefit from Check Imaging

Check imaging technology is expensive. Some large banks have recently announced major investments in this technology, but smaller banks may not have this technology. We have not seen any numbers suggesting that there will be a net cost savings in the banking system under the Act. More importantly, nothing in the Act guarantees that if there is a net cost savings, it will be passed on to consumers in lower fees or mandatory faster funds availability. Instead, the Act's push toward check imaging seems to be a way to reward large banks that have already made an independent business decision favoring check imaging.

Some bankers assert that check imaging enhances customer service. If consumers want check imaging, they are free to choose it without the Act. The Act does not enhance consumer choice. Instead, the Act *takes away* the consumer's choice to receive regular return of original paper checks.

The Act Will Make it Easier to Create Large Databases with Information from Check Images, but it Does Not Restrict What a Bank Can Do with Data from Its Customers' Checks

When databases exist, they will be mined for secondary use of the data unless that use is prohibited by law. Checks reveal a host of very personal information about individual shopping patterns. If the Act encourages check imaging, it could lead to more information from checks being stored, sorted, and used for other purposes by banks. While checks have always contained personal information, the fact that the information was on paper rather than in electronic form has provided some practical protection from bank snooping in a consumer's check spending patterns. When more banks use electronic check images, a bank could amass a large database of information about its check-writing customers. A database of check images could even allow a bank to determine which of its customers write checks to a religious institution, who gives to particular groups that reflect particular lifestyles or interests, or who makes political contributions to a particular party.

The CTA's New Consumer Protection Provision Has a One Significant Loophole, and the Check Clearing Act Has Additional Loopholes

The Act would take a system that works relatively well for consumers and change it in a way that saves money for banks and imposes new risks and new inconveniences on consumers. Act promotes the conversion of paper checks into electronic images. The Federal Reserve's proposal seems to acknowledge that when checks are converted into

electronic form, existing check law is inadequate. This is not surprising, since existing check law assumes the existence and close availability of a paper original. The Federal Reserve Board's proposal quite properly provides for a new consumer one business day right of recredit when there is a dispute about the payment of a check and other conditions are met. The Check Clearing Act is far worse for consumers, because it allows the bank to wait ten business days before recrediting the funds.

Both forms of the Act contain a large loophole in the recredit obligation. That loophole is that the consumer does not receive the protection of the one-day recredit right unless the consumer has received a substitute paper check. A consumer who received an image of the check, or no copy at all of the check, gets no recredit right.

The right of recredit is the key feature in this Act. A properly drafted recredit right could address part of the concern that converting check information between paper and electronic images offers new opportunities for error. However, a recredit right strictly limited to substitute checks that were provided to the consumer makes this Act a bad bargain for consumers. The recredit right is of extremely limited value when a bank can eliminate the recredit right simply by requiring that the consumer waive the right to receive back original or substitute checks.

Recredit should provide a simple, easy, low-cost consumer remedy for improperly charged checks. It makes no sense to give this remedy only to those consumers who receive substitute checks because they have declined to accept "voluntary" check truncation. Indeed, excluding voluntarily truncated checks from a recredit right would have perverse results. Consumer organizations would have to advise consumers that they will be better off if they refuse to agree to truncated checks, even though the effect of the refusal would be that the Act would force substitute checks on consumers who asked for original checks. Restricting recredit solely to substitute checks would increase the incentives financial institutions already have to try to induce or impose "agreements" for check truncation. We cannot support a statute that creates an incentive for financial institutions to induce waiver of the key right provided by that statute. The only way to avoid this is to make the right of recredit broad enough to apply to every check where the original is not returned to the consumer and there is an allegation of improper payment.

The recredit provision of the Check Clearing Act has this weakness and additional weaknesses. These include a delay of ten business days to give the recredit, and a shorter time to seek recredit. The time for the consumer to request a recredit of disputed funds is 30 days, with exceptions, under the Check Clearing Act. The Federal Reserve Board had recommended 60 days, with exceptions.

The Act Has Other Flaws

Many other provisions of the Act are of concern. Here are a few examples. The ceiling on any one-day recredit amount should be $5,000, not $2,500, because a $2,500

amount is too low and likely to quickly become out of date. If the much longer ten day time period is used, which we oppose, then there should be no dollar cap on consumer recredit, just as Regulation E has no dollar cap.

Another weakness is that the Act imposes a comparative negligence standard in determining who should bear a loss from a substitute check. Although a comparative negligence standard is used in parts of the Uniform Commercial Code, it is not a good standard to use between a bank and a consumer. The fact-based nature of a comparative negligence inquiry inherently favors the party with experienced counsel and the ability to bear litigation costs. Finally, the Act gives broad discretion to the Federal Reserve Board to modify the requirements of the Act with respect to substitute checks. This could be read to reach the content of the substitute check, yet it is a key premise of the Act that the substitute check must contain all of the information on the original check. The delegation of this power to the Federal Reserve Board, permitting it to use regulations to modify the Act's requirements, is too broad.

Congress should not take away from consumers the ability to get back and use their original paper checks. If Congress does wish to eliminate the paper check, over the opposition of consumers, it should at least do so in a way that gives all consumers who do not receive back the original paper check a clear right to recredit in the event of a dispute about whether a check was properly charged. This right should cease to apply only when the bank demonstrates that the check was properly charged to the account, not merely because there is a voluntary truncation agreement.

Following this testimony is an analysis of the consumer impact of the Act, presented in the form of the kinds of questions your constituents might have about the impact of the Act on their checking accounts.

Description of Groups Submitting this Testimony

Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education, and counsel about goods, services, health and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of *Consumer Reports*, its other publications and services, and from noncommercial contributions, grants, and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports* regularly carries articles on health, product safety, marketplace economics, and legislative, judicial, and regulatory actions which affect consumer welfare. Consumers Union's publications and services carry no outside advertising and receive no commercial support. Consumers Union maintains offices in Yonkers, New York; Washington, D.C.; Austin, Texas; and San Francisco, California, where it works to promote the consumer interest. Consumers Union participated in a working group convened by the Federal Reserve Bank of New York, and later facilitated by the Federal Reserve Board, to try to develop a check truncation act that would eliminate the

movement of checks without harming U.S. consumers. The CTA, which came out of that process, does not meet that goal. The Check Clearing Act is even further away from that goal.

The Consumer Federation of America (CFA) is a nonprofit association organized in 1967 to advance the interests of consumers through advocacy and education. CFA's current membership is comprised on almost 300 national, state, and local consumer groups throughout the United States, which in turn represent more than 50 million consumers. CFA advocates on fair banking practices, credit consumer protections and consumer protection in the payments system.

The National Consumer Law Center ("NCLC") is a Massachusetts nonprofit corporation established in 1969. One of its primary objectives is the provision of assistance to legal services attorneys, governmental agencies, and private attorneys in advancing the interests of their low-income and elderly clients in the area of consumer law. NCLC staff write and publish sixteen legal treatises on various federal and state statutes that affect consumer law. For over twenty years, NCLC staff have provided oral and extensive written testimony on numerous occasions to Congress, the Federal Reserve Board, the Federal Trade Commission, the Department of the Treasury, and other federal agencies regarding issues of importance to fair treatment and consistency in the marketplace for low-income consumers. NCLC staff have been members of the Federal Reserve Board's Consumer Advisory Council and participate on the American Bar Association Subcommittee on Consumer Financial Services of the Business Law Section.

U.S. PIRG serves as the national lobbying office for state Public Interest Research Groups, which are independent, non-profit, non-partisan research and advocacy groups with members around the country.

Conclusion

An estimated 45.8 million U.S. households should not be forced to make a change in the way they use their checking accounts to track personal finances particularly in the absence of a clear benefit to all consumers. The Check Truncation Act proposed by the Federal Reserve Board does not provide that benefit. The Check Clearing Act is even worse for consumers, because the bank can wait ten business days to recredit any funds. The Act should be rejected unless it is modified to provide a real and substantial benefit to consumers through a much broader right of recredit applicable whenever original checks are not returned, and other changes are made. Without a broader right of recredit, the Act would force a technological change on consumers without appropriate consumer protection. Banks would save money on check processing; consumers would experience new risks of delay, improper payment, inconvenience, and loss of privacy. Consumers Union, the Consumer Federation of America, the National Consumer Law Center, and U.S. PIRG respectfully suggest that this is a bad bargain for American consumers.

Statement of Lee Schram,

Vice President, Payment & Imaging Solutions Division, NCR Corporation

Testimony Before the

House Sub-Committee on Financial Services

On

September 25, 2002

In

Rayburn House Office Building, Room 2129

At

10:00 A.M.
"H.R. 5414 (Check 21) "

Chairman Bachus, Representative Waters, and members of the Sub-Committee, thank you for the invitation to testify.

My name is Lee Schram, I am Vice President of Payment & Imaging Solutions at NCR Corporation, a global provider of financial and retail technology solutions with over 100 years of experience in consumer transactions. NCR is the world's leading provider of ATMs and a global market leader in retail point-of-sale products. For over a decade, NCR has been providing imaging technology to banks and our solutions touch more than 70% of check transactions processed in the U.S.

Mr. Chairman, I represent NCR as well as a larger consortium of high tech companies including IBM, Unisys and others. In fact, I am submitting a letter from the Information Technology Industry Council in full support of House Resolution 5414. This legislation will make the check payment system more efficient, user-friendly, and provides clear direction and adequate protection for all parties involved.

Imaging technology is critical for successful bill implementation. Thus, it is important to understand the advanced state of this technology to demonstrate

its readiness and dispel concerns. Check imaging was introduced in the late 1980s. Most major and over 50% of community banks have been using it for over a decade. Internationally, many countries truncate checks. Imaging technology is readily available, secure, and reliable today. Image quality is superior to checks, better than microfilm, and each image can be uniquely identified and linked to the original check.

While the required technology is ready, concerns have been raised which I will address. First, while consumers may not be able to readily access the original check, image technology provides them with more options to access information including on-line banking and image statements while maintaining an audit trail to the original check transaction.

A second concern is the number of times a substitute document may be converted to a digital check. Ideally, truncation would occur at original point of presentment with no subsequent conversion. However, at least initially, substitutions will occur, but digital checks can be reliably created from substitute documents. Auditing processes exist to prevent duplicate entries prior to account posting thereby maintaining consumer protection.

A third concern, check readability, is eliminated as technology allows these images to be displayed in a wide range of sizes to meet consumer needs.

The benefits of the bill far outweigh these concerns. Changes in banking laws, written in an era when checks were cleared across town, not nationwide, have not kept up with technology advances, resulting in a costly, time consuming, and fraud-ridden check clearing process. Today, a check presented to a retailer or a bank is typically handled over 15 times.

Check 21 implementation would utilize technology advances to streamline the payment process and at the same time provide new, value added services to the consumer, like image enabling ATMs in more convenient locations. With Check 21, retailers, where over one-third of all consumer checks are written, will know within seconds if a check is good and fraud free. Consumers and retailers will gain quicker access to deposits as transactions clear electronically in minutes not days. Image-based transactions can be archived for years and quickly accessed by customers on-line via the bank's web site. For consumers not having on-line access, bank service centers will access images instantaneously upon request. The elimination of moving paper checks around the country will take significant cost out of the system -

- from couriers transporting checks to mail handling. One major bank spends $25M annually on courier service while another spends $20M opening envelopes. Market forces will ensure that consumers realize the savings that result from imaging. H.R. 5414 will also virtually eliminate payment system logistical interruptions such as the grounding of commercial air service for several days following 9/11.

NOW is the time to leverage advances in communications and information storage to facilitate more efficient payment clearing. The benefits of check imaging should not be withheld from consumers and financial institutions for another three years, as currently proposed.

NCR commends Director Roseman of the Federal Reserve and the Financial Services Committee staff who have worked in a cooperative manner to deliver a bill that is balanced, protects consumers, and recognizes the immediate and future needs in the payment system. Through existing proven technologies, consumers, financial institutions, and businesses can enjoy the benefits of checking accounts with a more effective payment system.

Mr. Chairman, I thank you and the Subcommittee for your time & attention.

Testimony of

Electronic Check Clearing House Organization

Before the

Financial Services Subcommittee on
Financial Institutions and Consumer Credit
of the
U.S. House of Representatives

on

The Check Clearing for the 21st Century Act

September 25, 2002

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. A list of the current members of ECCHO is attached at Appendix A to this testimony.*

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 described below.

ECCHO has been recognized and is supported as the national provider of clearing house rules for electronic check presentment and check image exchanges by the following financial services trade associations, clearing houses and data processors:

American Bankers Association	America's Community Bankers
Bank Administration Institute	BITS
Carreker Corporation	Electronic Check Services
EDS Information Services	Indep. Community Bankers of America
National Clearing House Assoc.	NCR
The Clearing House (NYCHA)	Payments Resource One
Puerto Rico Clearing House Assoc.	Silas Technologies Inc.
Sterling Commerce	Small Value Payments Company, LLC
Viewpointe Archive Services	WesPay

* Each ECCHO member does not necessarily subscribe to each position expressed in this testimony. Certain ECCHO members may be submitting their own statements to the Subcommittee.

ECCHO is honored to work with these organizations and institutions to promote the implementation and ongoing operation of electronic check programs.

In summary, ECCHO believes that the Check Clearing for the 21st Century Act (the "Act") offers the potential to significantly benefit all stakeholders in the check collection process, including banks and other depository institutions and their commercial and consumer customers. As discussed in more detail below, these benefits include exciting new products and services for bank customers, a significant reduction in the cost of check collection, and better insulation of the nation's payments system from disruptions to the air transportation system such as occurred after September 11th.

For the reasons discussed in this testimony, ECCHO is prepared to support the Check Clearing for the 21st Century Act, provided its concerns with the Act discussed below are satisfactorily addressed. ECCHO applauds Congressmen Ferguson and Ford for introducing the Act, and Chairman Bachus and this Subcommittee for holding this hearing to consider this important legislation.

Overview of Testimony

ECCHO's testimony consists of the following: (1) an overview of the efforts of ECCHO and its member institutions to electronify the paper check collection process; (2) a description of the current check electronification and truncation programs in operation today; (3) a summary of the benefits of check electronification and the potential benefits of the Act; and (4) a statement of ECCHO's views on the Act and a number of related issues.

I. ECCHO's Role in the Electronification of the Check Collection Process

Since 1990, ECCHO and its member financial institutions have been actively involved in the development of clearing house rules to use electronics to facilitate a more efficient check payment system. These clearing house rules govern the inter-bank check collection process and provide additional detail and operational procedures on existing check law to address the creation of electronic records of paper checks. To that end, ECCHO has developed an extensive set of rules and related commentary, consisting of over 350 pages, covering multiple check electronification scenarios, including electronic check presentment (ECP), check truncation, electronic returns, and check image programs.

The ECCHO Rules are the accepted industry standard for check electronification. As noted above, numerous organizations have endorsed ECCHO as the national provider of check electronification rules. In addition, SVPCo (the Small Value Payment Company, L.L.C.) has licensed the use of the ECCHO Rules for its owners and customers. A list of those financial institutions utilizing the ECCHO Rules through SVPCo is attached to this testimony.

In addition to its rule-writing function, ECCHO also serves an educational and advocacy role for the financial services industry on check-related matters, focusing on the electronification of the paper check process. These activities include sponsoring industry conferences and participating in legal and regulatory developments at the state and federal level relating to checks and the electronic conversion or truncation of checks.

Additional information about ECCHO can be found on the ECCHO website: http://www.eccho.org.

ECCHO's Involvement With The Check Clearing for the 21st Century Act

ECCHO has been working with its member institutions on issues relating to substitute checks since the Federal Reserve Board staff first proposed the concept in early 2000. ECCHO has attended all of the major discussion meetings with the various stakeholders in the check collection process that were sponsored by the Federal Reserve Board staff to discuss the substitute check concept, and submitted a number of comment letters and provided other input to the Federal Reserve Board staff regarding various issues raised by substitute checks. ECCHO also has worked with ECCHO member institutions and other financial institution representatives to consider various substitute check-related legal and operational issues.

In addition, ECCHO has been involved with its member institutions, other trade associations, check clearing houses and banking service providers to develop technical and operational standards and procedures for substitute checks. ECCHO is a participating member of the American National Standards X9.90 IRD (substitute check) Standards Committee and is chair of the American National Standards X9.37 Standard for Electronic Exchange Committee. These standards and procedures will be used by financial institutions to create and exchange substitute checks when the Check Clearing for the 21st Century Act is enacted into law.

II. Overview of Check Electronification Programs in the Financial Services Industry

To understand the potential impact of the Check Clearing for the 21st Century Act, the check electronification programs operating today in the United States must first be reviewed.

Most paper checks today are physically delivered by the financial institution in which the check is first deposited (called the depositary bank) to the bank on which the

check is drawn (called the paying bank). Delivering the paper check from the depositary bank to the paying bank can involve numerous check sorting processes and multiple intermediary collecting banks as the paper check moves through the check collection process.

In order to make this check collection process faster and more efficient, financial institutions have been implementing check electronification programs. The term "check electronification" is a general term that refers to various programs that convert or truncate a paper check to an image or other electronic record of the original check during the check collection process. Check electronification programs can take various forms, and generally include one or more of the following elements:

- *Check Image Truncation Programs.* The paper check is truncated (that is, converted) into a digital image as it moves through the check collection process. The image conversion can take place at the depositary bank, the collecting bank or the paying bank. Images can be used for the forward collection and/or the check return processes. The original paper check is stored by the paying bank or one of the collecting banks, or is destroyed upon, or some time after, conversion.

- *Check Safekeeping Programs.* The paper check moves through the check collection process, and is collected and "safekept" by the paying bank or by another entity, such as the Federal Reserve or a correspondent bank. The paying bank provides the customer with either a periodic statement describing the safekept check, or an image picture of the check. As with check image truncation programs, the original paper check that has been safekept may be destroyed after some period of time.

- *Electronic Check Presentment (ECP).* The depositary bank or a collecting bank reads the preprinted account number, bank routing number, dollar amount and check number (referred to as the "MICR information") and other information off

a paper check to create a separate electronic record that is sent to the paying bank. The original paper check either follows at a later date or is stored at the collecting bank. ECP can be used jointly with paper check collection, check image truncation and check safekeeping programs.

It is important for purposes of addressing the Act to distinguish the above-described check electronification programs – which electronify the inter-bank paper check collection process – from certain emerging electronic payment programs that use the check as a source document to initiate an automated clearing house (ACH) electronic payment to complete a payment from a consumer to a merchant or from a consumer to a biller. These ACH electronic payments are initiated at the merchant's point-of-sale or at a biller's lockbox processing center. Transactions that result from these ACH initiation programs are not processed or settled through the check collection process, and are not part of the paper check electronification programs described above. These ACH initiation programs are subject to the law of electronic fund transfers, and not check law. They would not be subject to the Act since they do not have the requisite image data to use the substitute check process. ECCHO is not involved in rules making for these ACH initiation programs.

The Benefits Of Check Electronification Programs

When considering the potential benefits of the Check Clearing for the 21st Century Act for the financial services industry, consumers, businesses, and the nation as a whole, one should not look solely to the substitute check process that is authorized by the Act. Rather, one must evaluate the benefits of the expanded use of check electronification that will more generally be facilitated by the Act, because of the ability of financial institutions, as discussed in more detail later in this testimony, to use substitute checks to extend the reach of check electronification. Therefore, to address the benefits of the Act, it is important to first address the benefits of check electronification generally.

Benefits For Consumers and Businesses:

- Financial institutions are already using image technology to provide valuable new products and services to both consumer and business customers, such as on-line access and review of customers' check images. The Act will encourage and support institutions to offer these products and services to even more customers sooner than they would otherwise. This will significantly reduce the amount of elapsed time between when a customer makes a request for information about a check and when the customer receives the requested information. In addition to the timely receipt of information, the customer might also be able to print a copy of the check for, or send a copy of the check to, a party questioning payment.

- Financial institutions can improve customer service by permitting the customer service representative to promptly access a check image and use it to respond to the customer's question and/or send it to the customer, thus providing much faster response to the customer's inquiry.

- Financial institutions could offer consumer and business customers a broader variety of deposit options or extended deposit cutoff hours. For example, a greater number of remote ATMs could offer deposit taking because electronic processing would eliminate the need for the expensive daily physical pick-up at the ATMs.

- By streamlining the collection and return processes, consumer and business depositors will have information about bad checks sooner and will be better positioned to collect from the check writer, thus reducing the amount of losses that depositors experience from bad checks.

Benefits For The Economy:

- The resources supporting the transportation, storage and processing of original physical checks should be reduced substantially or reallocated.

- By reducing the dependence of the check payment system on transportation networks, negative economic impacts from unexpected disruptions to the air transportation system can better be avoided, whether the disruption is caused by weather, natural disaster, terrorist attack or other types of crisis.

III. ECCHO's Views on The Check Clearing for the 21st Century Act

For the reasons discussed in this testimony, ECCHO is prepared to support the Check Clearing for the 21st Century Act. ECCHO applauds Congressmen Ferguson and Ford for introducing the Act, and Chairman Bachus and the Subcommittee for holding this hearing to consider this important legislation.

The Act will allow collecting banks to truncate paper checks and process them electronically, and will allow paper copies of the original checks (called substitute checks) to be delivered to those paying banks and their customers who do not agree to receive images or other electronic representations of their paper checks. The Act would provide as a matter of law that the substitute check is the legal equivalent of the original paper check, and that the substitute check can be sent to a bank or other person in the absence of an electronic exchange agreement. Additionally, the substitute check would be designed so that it could be processed exactly as if it were the original paper check.

Today, images of paper checks can be exchanged for payment only if the paying bank and its customer, as well as any collecting banks in the collection chain to which the check image is transmitted, have agreed to accept the image in lieu of the original

paper check. Accordingly, banks today must support two check processing processes—one for checks to be sent to banks which have agreed to check imaging and another for checks to be sent to banks which have not yet agreed to check imaging. The Act and substitute checks will encourage banks to migrate to check electronification because they will be able, if they so choose, to convert all of their paper checks to images. The image would subsequently be converted to a substitute check when a particular paying bank or its customer have not agreed to receive images in lieu of the original paper check. It is anticipated that over time the number of paying banks that have not agreed to receive images will decline. The Act would help bridge the gap to a fully electronic check collection system.

As discussed in detail earlier in this testimony, ECCHO believes that check electronification programs, as further encouraged and extended by the use of substitute checks under the Act, will promote significant benefits for banks, credit unions and other financial institutions and their business and consumer customers in the form of attractive new products and services, improved customer service, and new protections against check fraud. Moreover, the Act establishes the legal foundation for financial institutions to use new technologies, including tele-communications, the internet, image and data storage and retrieval technologies, to provide new and better services to their customers.

Discussion on Specific Sections of The Check Clearing for the 21st Century Act

While ECCHO is prepared to support the Check Clearing for the 21st Century Act, we do have a few concerns with, or recommendations for, certain provisions of the Act. We have set forth these concerns and recommendations below:

1. *The special recredit rights provided in Section 6 of the Act are not needed, as current check law provides consumers with appropriate protections.*

Section 6 of the Act would provide a consumer who receives a substitute check with certain recredit rights. The customer's bank under certain circumstances would be required to recredit the account of the customer up to $2,500 by the end of the 10th business day following receipt of the customer's notice that a substitute check was not properly charged to the account.

ECCHO believes that these special protections for consumer accounts are not warranted. At least 30 percent of all checks written by customers of financial institutions today are not returned to the check writers because they participate in a check image or check safekeeping program. The evidence is that customers are having very few unique problems associated with their participation in check image or check safekeeping programs.

Furthermore, ECCHO believes that the existing protections under current check law provide bank customers with appropriate protections against any problems that may arise with substitute checks. A customer that receives a substitute check continues to have all of the rights and protections provided under federal Regulation CC and the Uniform Commercial Code (the UCC), to the same extent as if the customer had been provided the original check. In particular, under the UCC, a financial institution is liable to its customer if it charges its customer's account for a check that is not "properly payable." A financial institution also is liable under the UCC to its customer if it fails to stop payment on a check that has not yet been presented for payment to the bank in accordance with the customer's instructions. This liability can exceed the amount of the improper charge to the customer's account, as a financial institution that improperly debits a customer's account is liable under the UCC to the customer not only for the amount of the improper debit, but also for the amount of any damages that are proximately caused by any wrongful dishonors resulting from the improper debit.

While ECCHO does not believe an expedited recredit procedure is necessary for substitute checks, if Congress determines such a procedure to be necessary, ECCHO believes that Section 6 of the Act contains the elements of a reasonable approach. In particular, the recredit procedure in Section 6 gives the customer's bank 10 business days to investigate the claim before being required to provide the provisional recredit, and 45 days to complete the investigation. The bank's ability to investigate a consumer's claim prior to being required to recredit the consumer's account is essential for the bank to avoid fraud losses from the new expedited recredit procedure. Similarly, the Section 6 expedited recredit procedure does not require the bank to provide notice to the customer before reversing a provisional recredit. Requiring a bank to give notice before reversal will undermine the bank's ability to protect itself from fraud, as it enables the fraudster the opportunity to withdraw the funds from the account after the bank has determined that a fraud is in progress.

2. Section 6(c) should be revised to reduce the maximum dollar amount of the expedited recredit requirement.

The current requirement in Section 6(c) that a financial institution recredit a consumer up to $2,500 per check (as opposed to a per day limit) is too high and will potentially encourage fraud. This high dollar amount is not needed since most check payments by consumers are for amounts less than $1,000. A recent Federal Reserve study found that 85% of retail checks are written for amounts of less than $925, and based on other data the estimated average monthly mortgage payment is less than $1,500.[1] Moreover, the $2,500 per check expedited recredit will encourage a fraudster to submit multiple fraudulent claims to a bank in a single day, and steal significant amounts from the bank before it is able to investigate and determine that the claims are fraudulent. We believe that an expedited recredit amount of $1,500 per day will

[1] According to the Mortgage Bankers Association, the national median price for an existing home is $147,200. The national median price for a new home is $177,800. A $1,500 monthly payment supports a mortgage of $204,000, assuming a 30-year term at 8% interest.

provide bank customers sufficient funds until the bank is able to resolve the matter in question while appropriately protecting the bank from significant increases in fraud losses. Losses from check fraud are a real and significant concern to banks, as it is estimated that banks lost almost $700 million from fraud in 2001 alone.

3. *Banks should not be required to provide interest on amounts recredited under the expedited recredit procedure in Section 6.*

Section 6 requires a bank that does not complete within 10 business days its investigation of a consumer's claim of an improper charge resulting from a substitute check to provisionally recredit a customer up to $2,500 or the amount of the check, whichever is less. The bank is also required under Section 6(c)(1)(B)(ii) to pay interest on the amount recredited. ECCHO objects to this requirement to include interest in the expedited recredit amount. First, given that the time period from the date of the improper charge to the date of the expedited recredit will necessarily be fairly short, and that the amount of the recredit relatively small (the amount of the check up to $2,500), the actual amount of interest to be recredited will be quite small, even in some cases less than a penny. For example, interest on a $1,000 expedited recredit at two percent interest is approximately 5 1/2 cents per day. While the benefit to consumers of this provision is low, the cost of compliance could be very high, as banks will have to implement new programs and procedures to calculate this interest on the recredited amount and add it to the customer's account.

4. *The Section 6(c)(4) prohibition on a bank imposing overdraft fees with respect to checks drawn by a customer for 5 days after the delay of a recredit should be modified.*

Section 6(c)(4) of the Act prohibits a bank from imposing overdraft fees with respect to checks drawn by a customer on a recredited amount for 5 days from the date notice of the delay is provided to the customer. This requirement would impose significant

operational costs on banks as they would need to identify when an overdraft has resulted from delayed availability of an expedited recredit. Many banks' systems do not currently identify on an automated basis the reason for an overdraft, and these banks would be required to incur significant expense to revise their demand deposit account and other systems in order to comply with this Section 6(c)(4) requirement. We recommend that this section be revised along the lines of Section 229.16 of Regulation CC. This section of Regulation CC provides that the bank may not assess overdraft fees if the bank fails to provide notice to the consumer of the delayed availability for a check deposit. We believe that these are analogous situations of delayed availability of funds, and should be treated the same. As with Regulation CC, where the requisite notice to the consumer of the delayed availability of the expedited recredit is provided to the consumer, the consumer has knowledge of this delayed availability before drawing checks or effecting other transactions against these funds.

5. The requirements and details for the consumer awareness program provided for under Section 10(b) should be left to the Federal Reserve Board to determine.

Section 10(b) of the Act requires financial institutions to mail a document prepared by the Federal Reserve Board to their current and potential customers. We believe that this section should be revised to eliminate any specific requirements as to customer awareness, and instead require the Federal Reserve Board to adopt regulations detailing the requirements for customer education and awareness regarding substitute checks.

Fixing the required customer awareness program by statute, as opposed to regulation, will make it difficult to change these programs as services and products using substitute checks evolve over time.

Moreover, the appropriate type of consumer education and awareness efforts will vary across financial institutions. For example, a bank that receives check images, and not paper checks, from all other banks will generally not receive substitute checks. A mailing of the type contemplated by Section 10(b) will not only be a waste of money for this bank, but will confuse its customers who will never receive a substitute check. Similarly, the appropriate type of customer education and awareness programs may vary by the size of institutions, with larger institutions requiring different programs than smaller institutions. Provisions also should be made for different types of customers, for example on-line banking customers, to receive notifications in different ways. Given these reasons, the consumer awareness program should be left to regulatory implementation.

6. *The effective date of the Act should be shortened.*

ECCHO supports shortening the current effective date for the Act to a period no longer than one year from the date of enactment, if not shorter.

Implementation of the Act holds the promise of reducing the payment system's dependence on transportation disruptions such as occurred on September 11th. Delaying the enactment unnecessarily delays the removal of this risk and prolongs an economic risk to the entire economy. Furthermore, delays in enactment postpones the realization of consumer and commercial customer benefits and postpones the creation of a more efficient payments system to benefit the nation's economy overall.

The use of substitute checks under the Act is optional for truncating banks, so an earlier effective date will not force a bank to begin imaging or truncating checks if it does not want to. Similarly, there is no need to delay implementation for paying banks and their customers. Because the substitute check is designed to be processed like a paper check and is under the Act the legal equivalent of the paper check, it will have little impact on paying banks and their customers.

Simply put, we have the opportunity to reduce risk to the economy, create a more efficient payment system and accelerate the creation of new, valuable benefits for bank customers. These will only be delayed by an effective day of January 1, 2006.

Other Issues Raised Regarding The Check Clearing for the 21st Century Act

During the deliberations regarding substitute checks in various forums over the past two years, a number of additional legal and operational issues have been raised regarding the use of substitute checks as contemplated under the Check Clearing for the 21st Century Act. ECCHO addresses these issues below:

1. Would the use of substitute checks, as authorized by the Act, negatively impact consumers?

A consumer's receipt of a substitute check, as opposed to the original check, should not have a negative impact on the consumer. The substitute check contains a picture of the original check, and retains all the information from the original check – including payee and drawer names, amount and date, memo notations, signatures, and endorsements. Experience with existing check electronification programs -- which ECCHO estimates currently involve approximately 30 percent of checks written by bank customers and substantially all of the checks written by credit union members -- demonstrates that consumers have very few complaints from receiving images or other alternatives to their original checks.

Under the Act, the substitute check would as a matter of law be the legal equivalent of the original check. The same protections provided to consumers today under the Uniform Commercial Code, Federal Reserve Board Regulation CC and other law for paper checks would also apply to substitute checks. In addition, Section 5 of the Act would provide additional legal protection to a customer in the form of an

indemnification for losses arising from the receipt of a substitute check instead of the original check.

2. Should the specific consumer protection provisions in the Act for substitute checks also apply to other check truncation and image programs operating today?

ECCHO strongly opposes any expansion of the scope of the Act that would impose protections or requirements on check safekeeping, check truncation, check image or other check electronification 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 very few

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.

For these reasons, ECCHO would strongly oppose any proposed legislation that would apply new requirements to check safekeeping, check truncation, check image or other check electronification programs that do not involve a substitute check.

3. Does the Act eliminate a consumer's ability to "choose" a marketplace option that permits the consumer to receive original checks back?

It is correct that the Act will limit the ability of a consumer to choose to get his or her original paper checks back. However, a consumer that does not get back the original paper check would receive a paper recreation of the original check (the substitute check), which contains a picture of the original check that reflects all of the information from the original paper check, is by law the legal equivalent of the original check, and carries with it the other special legal protections provided under the Act.

If every consumer is allowed to choose to get his or her original checks back, the full benefits – to all consumers and the economy – of check truncation and electronification will be significantly delayed. This is because a financial institution early on in the check collection process will have no way of knowing which checks would need to be returned in original form, and which checks can be truncated. This would force these financial institutions to preserve the paper checks and move the physical paper checks all the way to the paying bank. With the Act, the first bank in

the process can truncate all the checks it receives for processing. This in turn, as discussed above, will benefit consumers and the economy as a whole with new products and services and a more efficient and secure national payment system.

4. Will the use of substitute checks or other check electronification programs compromise consumer privacy rights?

The use of substitute checks will not compromise the privacy of customer information. The financial institutions that participate in the U.S. check collection system are subject to the information privacy and security protections of the federal Gramm-Leach-Bliley Act. These privacy protections will apply to information that is exchanged as part of the check collection process.

Moreover, the use of substitute checks or check truncation does not result in any additional disclosures of customer information, as compared to the current paper check collection process. The same customer information that is on the paper check today will be on the substitute check. No additional consumer information is released or otherwise provided to anyone as the result of the Act, the use of a substitute check, or check truncation generally.

5. Will the Act speed up check clearing, without shortening the amount of time a financial institution can hold a consumer's funds?

Before the Act is enacted and implemented, it is unclear how significantly the Act would speed up the check collection process or otherwise influence the amount of time financial institutions hold consumers' funds after a check is deposited. ECCHO anticipates that over time, greater check truncation will result in faster collection of funds for depositing customers.

The federal Expedited Funds Availability Act ("EFAA") requires the Federal Reserve Board to reduce the funds availability schedules to as short a time as reasonably possible. As such, the Federal Reserve monitors check collections times, and if checks are being collected faster as a result of the Act, the Federal Reserve has existing authority under the EFAA to reduce the amount of time that financial institutions can place holds on deposited checks. Indeed, the Federal Reserve in the past has indicated[2] that when 2/3 of the checks in a given category are collected faster than was the case when the EFAA was enacted, it will shorten the mandated availability period for that category of check.

Conclusion

ECCHO appreciates this opportunity to present its views to the Subcommittee on the Check Clearing for the 21st Century Act and check electronification programs. ECCHO looks forward to working with the Subcommittee in any way that would be of assistance to the Subcommittee as it continues its consideration of this important legislation.

* * * * *

[2] See, for example, Board of Governors of the Federal Reserve System, Advance Notice of Proposed Rulemaking; Withdrawal, 64 Fed. Reg. 37708 (July 13, 1999).

Appendix A

ECCHO Member Institutions

The following institutions are members of ECCHO:

Bank of America	Bank One
BB&T	Citicorp
Comerica	Deutsche Group
Fleet Boston	Frost National Bank
First Tennessee	HSBC Bank
JPMorgan Chase	KeyBank
Mellon Bank	PNC Bank
SunTrust	U.S. Bank
Union Bank of California	Wachovia
Wells Fargo	

Additional Institutions Under ECCHO Rules through SVPCo

ABN AMRO	Bank of New York
Central Carolina Bank	National City Bank
National Commerce Bank	Sterling National Bank

INFORMATION TECHNOLOGY INDUSTRY COUNCIL

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Vice President

September 25, 2002

The Honorable Spencer Bachus
Chairman, Subcommittee on Financial Institutions and Consumer Credit
2129 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

I am writing to express my support for, H.R. 5414, "the Check Clearing for the 21st Century Act" (Check 21), and to thank you for considering this important issue. Passage of Check 21 will allow financial institutions and their customers to take advantage of digital technologies and electronic commerce, promoting greater long term efficiencies in the check clearing process. The Information Technology Industry Council's (ITI) support of this legislation is an important part of my industry's sustained commitment towards promoting digital trade and online transactions, benefiting both businesses and consumers.

Improving the payment processing system as well as customer service by streamlining the collection and return processes, Check 21 offers a variety of benefits and encourages innovative new products and services for both consumer and business customers. Digital technologies offer an increased level of protection for consumers and industry from unexpected disruptions to the transportation networks on which the current check payment system relies. By promoting electronic rather than physical transactions, emergencies such as terrorist attacks and severe weather will no longer have such a potentially devastating effect on payment processing systems. The legislation also helps provide the legal framework for conducting e-commerce, making this protection possible.

ITI has long supported the continued development of a legal framework for electronic commerce. In June of 2000, we strongly supported passage of "the Electronic Signatures in Global and National Commerce Act," providing legal validity to digital signatures for online and other transactions. Check 21 is an important next step towards promoting electronic commerce and economic growth through innovation.

ITI represents the leading U.S. providers of information technology products and services. In 2000 ITI member companies employed more than one million people in the United States and exceeded $668 billion in worldwide revenues. ITI looks forward to working with you to pass this important legislation.

Best regards,

Rhett Dawson
President

The association of leading IT companies

Agilent • Amazon.com • AOL Time Warner • Apple • Canon USA • Cisco • Compaq • Corning • Dell • Eastman Kodak
EMC Corporation • Hewlett-Packard • IBM • Intel • Lexmark • Microsoft • Motorola • National Semiconductor • NCR • Panasonic
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NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS
3138 10th Street North • Arlington, Virginia • 22201-2149
(703) 522-4770 • (800) 336-4644 • FAX (703) 524-1082

September 25, 2002

The Honorable Spencer Bachus
Chairman
House Subcommittee on Financial Institutions
and Consumer Credit
2129 Rayburn House Office Building
Washington, D.C. 20015

Dear Chairman Bachus: Mr. Chairman

I am writing on behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents the interests of our nation's federal credit unions, to share with you some of our thoughts regarding the "Check Clearing for the 21st Century Act", H.R. 5414.

Under the bill, a financial institution could create a paper document known as a "substitute check" from an electronic check image of the original check. NAFCU supports the efforts in this Act and believes that both the financial services industry and American consumers and businesses will benefit greatly from the reduced handling costs and efficiencies gained through expedited collections.

As you are aware, credit unions have been "truncating" share drafts ("checks") for over 20 years, even though it has not been required by the National Credit Union Administration (NCUA) since 1982. Credit unions account for 4.7 billion of the 42.5 billion checks written each year in the United States and 91% of the credit unions that offer share draft accounts utilize truncation.

Choosing to truncate share drafts has been a matter of choice and preference for credit unions for the last 20 years and we are pleased to see that the bill does not make a mandatory imposition of truncation. Truncation has proven successful for credit unions. History has shown that credit union members rarely request copies of their share drafts, and request their original checks even less often.

NAFCU would recommend one change to H.R. 5414. Specifically, we recommend that Section 7 be amended to reduce the timeframe for an institution to submit a claim for expedited recredit from 120 days to 90 days. Ninety days (calendar days, not business days) from the statement date should be more than sufficient time for the account holder

to receive the statement and to identify any errors, leaving 30 days for the expedited recredit process.

The credit union movement began to truncate share drafts at the their inception in 1974, using imaging processes similar to the "substitute check" and continues to do so today with great success. We are pleased that this bill would allow existing credit union truncation programs to continue and coexist. NAFCU supports this effort put forth by Representatives Ferguson and Ford to encourage all financial institutions to use this technology as a means to improve the efficiency of the nation's payments system.

NAFCU would like to thank you for this opportunity to share our views on the "Check Clearing for the 21st Century Act". We look forward to working with you, the authors, and the Subcommittee on this legislation. If we may provide you with any additional information or answer any questions regarding this issue, please do not hesitate to contact me or NAFCU's Director of Legislative and Political Affairs Brad Thaler at (703) 522-4770.

Sincerely,

Fred R. Becker, Jr.
President and CEO

Mr. Chairman:
As always, thanks for your support!

cc: The Honorable Mike Ferguson
The Honorable Harold E. Ford, Jr.

AirNet
TIMELINES
SPECIAL EDITION

This newsletter is devoted entirely to recognizing our AirNet family, which consists of all the "front-line" teams as well as the "behind-the-scenes" teams, who gave up their own plans and gave of themselves for days on end to keep our nation's payment mechanism moving. This, at times, was a daunting task, yet those who rose to the occasion are impossible to single out.

As you will see while reading the enclosed letters and e-mails from customers and team members alike, it would have been an impossible task to select *only a few* team members who were "ACE-worthy." There are ***hundreds*** of "AirNet Shining Stars" who deserve an award for all they did in the days following the attack on America.

As Kathy Brown (IND) said in her letter on page 5, and Sue Holt (MEM) summarized in her letter on page 9, the events following the attack have shown many of us what it truly means to have an "AirNet Family."

Because of our commitment to "family," we are making a donation in the names of all those about whom you will read on the following pages. In addition, we will present a specially designed shirt (different from all other AirNet shirts) to each of the named individuals. It is our hope that these shirts will be worn with AirNet pride.

Some efforts were more visible than others, but the actions taken were always the same. We pulled together as one team, cross-functionally, nationwide, with a common focus toward one goal.

We should all be very proud and thankful for our own families. They supported our time away from home as we came together as one big AirNet family to tackle the daunting tasks of that record-volume week.

Many, many thanks... to each of you and to your loved ones... for a job well done!

America: The Good Neighbor

by Gordon Sinclair, a Canadian television commentator

This Canadian thinks it is time to speak up for the Americans as the most generous and possibly the least appreciated people on all the earth.

Germany, Japan and, to a lesser extent, Britain and Italy were lifted out of the debris of war by the Americans who poured in billions of dollars and forgave other billions in debts. None of these countries is today paying even the interest on its remaining debts to the United States.

When France was in danger of collapsing in 1956, it was the Americans who propped it up, and their reward was to be insulted and swindled on the streets of Paris. I was there. I saw it.

When earthquakes hit distant cities, it is the United States that hurries in to help. This past spring saw numerous American communities flattened by tornadoes. Nobody helped.

The Marshall Plan and the Truman Policy pumped billions of dollars into discouraged countries. Now newspapers in those countries are writing about the decadent, warmongering Americans.

I'd like to see just one of those countries that is gloating over the erosion of the United States dollar build its own airplane. Does any other country in the world have a plane to equal the Boeing Jumbo Jet, the Lockheed Tri-Star, or the Douglas DC 10? If so, why don't they fly them? Why do all the international lines, except Russia, fly American planes?

I can name thousands of times when the Americans raced to the help of other people in trouble. Can you name me even one time when someone else raced to the Americans in trouble?

Our neighbors have always faced it alone, and I'm one Canadian who is damned tired of hearing them get kicked around. They will come out of this thing with their flag high. And when they do, they are entitled to thumb their nose at the lands that are gloating over their present troubles. I hope Canada is not one of those.

Stand proud, America!

FROM OUR CUSTOMERS.....

From: tracy.davies@bankofamerica.com
Sent: Thursday, September 20, 2001 10:32 AM
To: **hideo_core@airnet.com; dave_newman@airnet.com; cindy_penrose@airnet.com; Jeff_harris@airnet.com**
Cc: wes.brown@bankofamerica.com; robert.bean@bankofamerica.com; Karen.K.Chin@bankofamerica.com; Arthur.Ramirez@bankofamerica.com
Subject: **Special Thanks to AirNet**

On behalf of **Float Management at Bank of America**, I would like to express our sincere thanks for your dedication to service during the recent tragedy. Your commitment to your customers has always been evident in your customer service and delivery quality, but recent events have proved your competent staff to be exceptional. They reacted quickly and implemented necessary changes to mitigate losses for your customers including Bank of America. Art Ramirez has expressed time and time again how AirNet stepped up to help in every possible way.

This has been a difficult time for all, but AirNet has exhibited tireless professionalism in the wake of a terrible tragedy in our Country.

Thank you again for your dedication to keeping the payment system "moving".

From: **vickie.coffin@amsouth.com**
Sent: Tuesday, September 18, 2001 11:22 AM
To: cindy_penrose@airnet.com; hector_pena@airnet.com
Cc: proyal@amsouth.com
Subject: LaSalle, Chi

Please thank your couriers for the extra effort they've put into their work in the last week, but ask them to be careful.

Vickie Coffin
Float Management
AmSouth Bank

From: **King, Guy**
Sent: Wednesday, September 19, 2001 5:01 PM

I was asked by **Network Courier's** President and owner Rudy Markmiller and by Darrell Zemba their Eastern Vice President to pass along sincere thanks for the service we provided to Network during the last five days. They reported that everyone at AirNet was kind, courteous and extremely helpful and wanted me to thank **Rich Straka** and **Jerry McKnight** in particular for their assistance over the weekend.

From: John.D.Martin@huntington.com
Sent: Wednesday, September 19, 2001 3:49 AM
To: Core, Hideo

Hideo, thank you for the information. I can't say enough about how your team has really been at the top of their game through this terrible time in our history! Thanks to all your folks from **the Huntington!**

John

SunTrust
SERVICE CORPORATION
PO Box 26150
Richmond, VA 23260-6150

September 17, 2001

Mr. Joe Biggerstaff
AirNet Express
3939 International Gateway
Columbus, Ohio 43219

Dear Mr. Biggerstaff:

I would like to preface this letter by saying that, during the oil embargo of the seventies I managed over a million sq. ft. of public warehouse in three cities with a fleet of 35 trucks. I know what my problems were then, so I cannot imagine what you and your staff have gone through this past week.

Every one of them that I have had contact with has been most helpful and informative, as well as professional, as they are on a daily basis. **Hideo Core,** as always, tried to be most helpful, as did **Cheryl Denman. Cindy Penrose** and her team (**Geni Jacobs, Carol Kelly, and Simone Baker**) daily went our of their way to try to help.

It is obvious to me that these folks could not have done the job that they did without **Scott Jacobs** and the rest of your operations people.

This has been a horrible time in the history of our country. I would like to think that with your help, we in the banking industry have been able to strike back a small blow by continuing to operate. This is all that we can do.

Thanks again for doing an impossible job... and it was well done.

Sincerely,

Ronald E. Hall
Traffic Manager
SunTrust Service Corporation

From: Kim.DeFusco @ mnco.com
To: Joe Biggerstaff

Just a note to thank you and your staff for the remarkable job done over the past week. Both our account rep, **Hector Pena**, and the ground staff here in Detroit worked hard to make sure pick-ups were met, even as far as making last minute additions to our current dispatches, with Fed relay not running. The operational update meetings held were very helpful in keeping everyone apprised of situations. Thanks again.

From: Sandy.Bond@wachovia.com
Sent: Monday, September 17, 2001 5:04 PM
To: Joe_Biggerstaff@airnet.com
Subject: AirNet VA Saturday Pick-up

I just wanted to tell you about the extra efforts put forth by **Cyndi Moore** on this past Saturday VA special pick-up. She was very instrumental in assisting me with getting our work in the hands of an AirNet driver in Richmond.

Over all, AirNet's operations people in Columbus all pulled together and worked very hard putting in a lot of long hours. Their efforts have not gone unnoticed and were greatly appreciated. Please send my thanks and appreciation to all of the people who worked very hard during this crisis. Thanks again...

From: regis.reinersmann@pncbank.com
Sent: Wednesday, Sept 19, 2001 4:09 PM
To: joe_biggerstaff@airnet.com; jeff_harris@airnet.com
Subject: Great Job

Joe / Jeff - Last week our nation experienced the most horrific, tragic event in our history. Your company and the nation's check clearing system was dramatically impacted by the inability to fly planes and move checks.

I want to commend your organization for responding to this disaster situation in a highly efficient manner. Your teams kept the banking industry informed on a timely basis regarding updates from the FAA as well as the airports. Once approval to begin flight operations was received, AirNet's operation, beginning last Thursday and going through the weekend and into Monday, was extraordinary! Your customer conference calls were informative and managed professionally. The continuous updating of AirNet's WebCheck system provided banks the ability to track shipments throughout the weekend.

While I will single out the great work that **Steve Lister, Dave Newman, Bill Vietch, Hideo Core, Ernie Bezemes** and **Carol Kelly** performed last week, I know there are several hundred other individuals that contributed to AirNet's performance.

PNC Bank would like to extend our thanks to your entire team for a great job last week.

From: Kelley.Harris@chi.ddb.com
Sent: Thursday, September 27, 2001 3:52 PM
To: Joe_Biggerstaff@airnet.com

Joe, I just wanted to take a minute of your time to let you know how much we here at **DDB Chicago** appreciate all the extra efforts in the past few weeks from some key people there at AirNet. Starting with **Kathleen Johns**, she helped us immensely the week of the tragedies in New York — by coordinating shipping in and out of New York when no other companies offered alternatives to our desperate needs ... she had no problem giving us options so we could continue our business with our clients. Extra efforts were also given by **Misty Duffy** and **Cheryl O'Neil** in the AM and then at night, I don't know what we would do without the help of **Amber Barnstable (CMH)** and **Carl Benninghouse** here in Chicago. I know I haven't been able to mention all who help out on a daily basis but these few I have mentioned are the BEST when it comes to professionalism and knowing how to help make us look good.

BANK ONE

Dear Jeff:

All of us at **Bank One** would like to thank you and the entire AirNet team for your efforts over the past week.

The events from September 11 created an enormous impact both personally and professionally for all of us. Throughout this entire event, AirNet was there to keep us updated on ever-changing events and work with us as we made alterations to our normal schedules.

We particularly want to single out the support we received from **Hideo Core** during this process. We at Bank One are very appreciative to have Hideo as our National Account Representative. During this entire week, Hideo was very responsive to our needs and provided the communication to us that allowed our team to provide instructions to the various sites on expectations regarding both pickups and deliveries.

As always, the Customer Support staff was an excellent resource for information. In particular, **Simone Baker**, our primary support contact, really went above and beyond in her determination to answer questions and communicate our requests.

Again, our thanks to AirNet for your superior work under very difficult conditions. Bank One values the partnership between our organizations and we look forward to working with you on many initiatives in the future.

Sincerely,

David Hill
Bank One National Float
Management and Transportation

(The following is a voice-mail message from Alan Lee, Senior Vice President, US Bank, to Jeff Harris.)

Jeff, I wanted to express my thanks for you guys and your professionalism. It is absolutely incredible what you've pulled off this week. I don't know that I can think of anybody else in your industry that could have done it. I don't believe there is anyone.

You and **Dave Newman** exemplify what it should be all about. You are to be commended for all your effort and certainly for the leadership roles you both have played.

I know it certainly wasn't perfect because of all the volume in the system, but it was an absolutely remarkable job and it doesn't go unrecognized, the talents that you guys have amassed there at AirNet.

(This note accompanied a large box of Lifesavers candy.)
TO: **Jeff Harris**
FROM: John Quinn, Bank of America

On behalf of the Bank of America, we would like to extend this symbol of our appreciation for your PARTNERSHIP, HARD WORK, AND DEDICATION in the aftermath of our country's recent tragedy.

You ALL truly have been "Lifesavers"!

John Quinn
Transaction Services Executive
Bank of America

FROM OUR TEAM....

From: **Farkas, Steve (CMH)**
Sent: Thursday, Sept. 20, 2001 12:44 PM

Here is a list of my team that I feel went above and beyond the call of duty, not so much with changing job duties, but these gentlemen worked every single hour needed, no matter what day or schedule, to complete the huge task of moving a record volume of checks and medical supplies around the country. They are:

Chris Ruth, Matt Gripper, Charles O'Dell, Joe Hardesty, Charles Cornute, Jesse Hartman, Charles Johnson, Bobby Patrick. These guys were my star players this past week.

I know there were some people who could not work every hour they were needed, but listed below are my guys who deserve a round of applause for their efforts in helping by coming in for nearly all of the hours needed. They are:

Nick Arnold, Mike Henry, Donyell Bryant, Ezekiel Bono, Nate Tamru, Jason Rainey, John Troyan, Mikias Tamru, Ed Millen, Jim McNellis, Brian Butler, Darrell Brown, Dave Chemnitz, Eric Bossone, James Moore

Some of these fellas even went down to Rickenbacker Industrial Park in their own cars to sort over 25,000 pounds of checks.

From: **Kay.Paul@WellsFargo.COM**
Sent: Wednesday, September 26, 2001 11:51
To: ernie_bezemes@airnet.com
Subject: Geni Jacobs

Ernie, I have to take a moment to send this letter to compliment the excellent customer service Wells Fargo has received from **Geni Jacobs**.

Before September 11, Geni was efficient, friendly, professional and knowledgeable. What I would like to highlight is that after all the last minute alterations of every aspect of our Cash letter dispatch times, Geni has remained all the adjectives I listed before. Her communications and listening skills were above average. She paid attention to details and seemed to be willing to constantly endeavor to make my job go as smooth as possible.

I could go on with many other kind words, but mainly I just wanted to let you know how much I personally appreciate and enjoy working with her.

L. Kay Paul
Wells Fargo Services Co.
Float Operations

From: **O'Neil, Dave**
To: Joe Biggerstaff
Sent: Thursday, September 20, 2001 10:58 AM

Chuck Baye in UCA did a fantastic job! He was available around the clock for us. He did numerous drive outs. In one instance, he was to meet a truck from BDL going to PIT in Scranton, PA. Chuck arrived prior to the BDL truck arrival. He called in looking for the truck. After determining that the BDL truck was running way behind, Chuck volunteered to meet it somewhere else to speed up the process. I would say he was on the road for probably 12-14 hours with no complaints and willing to do whatever was necessary to get things done. As I said, he was available 24 hours during the crisis and never once said no to us. I asked all stations to track their costs. Chuck turned in 10 hours of O/T for his people and never asked for a penny for himself.

JoAnn Knob was here for the entire time taking 4- and 5-hour catnaps to try to refresh herself. The first day she was here for approximatley 32 hours. She handled a lot of the communications between CMH and the field. We used her

desk as the ground hotline and asked ground folks to funnel all questions/problems through that number. At times, we transferred her phone to a desk in Dispatch, which we manned, or when she was here to her cell phone so that she could be available to help with loading, unloading and sorting of aircraft/trucks. She averaged working about 20 hours a day. If we would have allowed her, she would have stayed for every hour of the crisis.

Brad Ramer - Brad was thrown into the mix to help with whatever was necessary. At times he was making phone calls and the next minute he was working the sort and loading and unloading. His schedule changed constantly to try to fill holes in the manning of the field ops area.

Jon Powers - I do not believe Jon left the APA office from Tuesday until Sunday. He handled all communications from APA west for the ground and airline. CMH used him as the funnel for all communications for the west.

From: **McEnany, Phil**
Sent: Thursday, Sept. 20, 2001 10:03 AM

I am forwarding the e-mails from my cities regarding the team members who worked above and beyond the call of duty. As you will see, no one really wanted to single out any one person.

Please remember **Jeff Hall** in this. He came to CMH for a one-day visit and stayed for five.

The following is a message from Jeff Hall to the station managers in his region, and their responses:

From: **Hall, Jeff**
Sent: Tuesday, September 18, 2001 4:22 PM
To: Cheatham, Riley; Croan, Bob; Dean, Jim; Gilbert, Quinn; Fambrough, Dave; Antolik, Jim

Please send me a list of team members who you think worked above and beyond the call of duty. My sincere appreciation goes out to everyone who helped serve the Nation's Payment System during the crisis. I couldn't be more proud of you!

From: **Cheatham, Riley**
To: Hall, Jeff
Sent: 9/19/01 9:39 PM

I can't single out just one individual because my whole team went above and beyond our regular duties to make sure everything went well. My team includes **Kathy Brown, Larry Brown, Marty Faidley and Bill Ring.**

FROM: **Kathy Brown**
Sent: Wed. September 19, 2001

It's hard to single out just one person here in Indy. As you know, there are only five of us and all five pulled together and worked wherever we were needed.

You have **William Ring**, who has another job, but was right there for us - to drive and deliver work. **Larry Brown**, who also has another job, gave up some sleep time to wait on trucks and meet the drivers, then deliver the work. Then we have **Marty Faidley**. Well, you know Marty. He is like the "EverReady Bunny;" he just doesn't stop. **Riley Cheatham** practically lived at our FBO. He had an emergency with his wife, but he knew I was here to take over for him. While he was with his wife, he continued to check in with me. He said he knew I would handle things, but still touched base with me. As for me.... I waited on trucks, delivered work also, and I did enough worrying for all of us.

We all pulled together.... not just because of our jobs, but because we care for all those who are gone, and for all of their families. We all said that we didn't know the meaning of the "AirNet Family" before September 11; however, we most certainly do now. Jeff, I work with a great group of guys and could not have been more proud to be an American.

So you see, Jeff, in my opinion, all of us here in Indy pulled together and kept ourselves up and functioning as it should be - being an AirNet employee.

Sincerely,
Kathy Brown

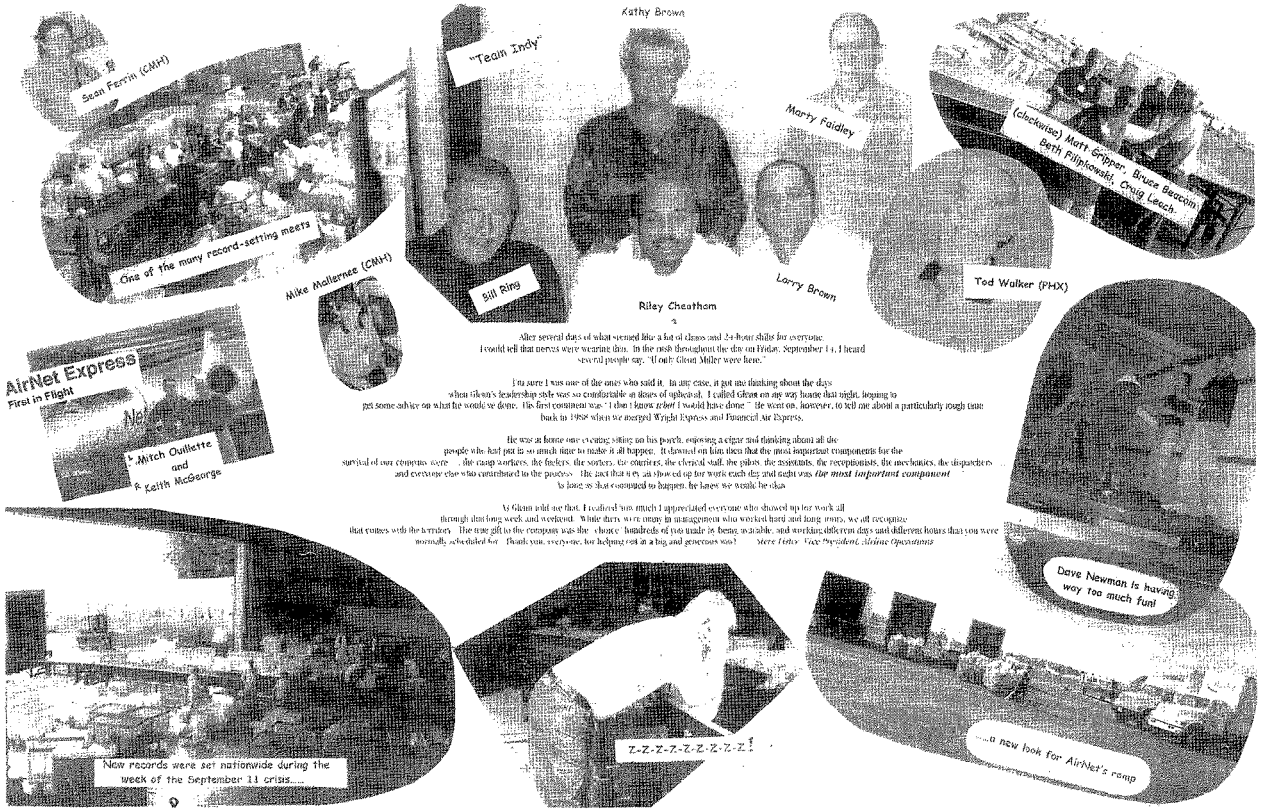
From: **Chris Ruth**
Sent: Tuesday, September 18, 2001

On Friday, 9/14, **Mike Sowers** came in early to help out with the aircraft overflow. Also on Friday, I was informed we would have an air meet on Saturday, 9/15, and Sunday, 9/16. With very short notice I easily assembled a team of people who were very willing to work. They are: **Ken Riggs, Bryan Hoy, Zack Prauetsack, Tom Dornbrier, Wayne Aamot, Greg Phillips, and Rodney Swanigan.** And most of these guys also helped unload a few aircraft.

From: **Croan, Bob**
Sent: Wednesday, Sept. 19, 2001 11:17 AM
To: Hall, Jeff

Everyone pitched in and made adjustments to their personal schedules to be available when we needed them. Nothing spectacular transpired.

If I had to single out anyone who made the biggest personal efforts, it would be the two drivers who made several trips to Columbus: **Jackie Noe** and **Ronald Galloway.**



After several days of what seemed like a lot of chaos and 24-hour shifts for everyone, I could tell that nerves were wearing thin. In the mêlée throughout the day on Friday, September 14, I heard several people say, "If only Glenn Miller were here."

I'm sure I was one of the ones who said it. In any case, it got me thinking about the days when Glenn's leadership style was so comfortable in times of upheaval. I called Glenn on my way home that night, hoping to get some advice on what he would've done. His first comment was "I don't know what I would have done." He went on, however, to tell me about a particularly tough time back in 1988 when we merged Wright Express and Financial Air Express.

He was at home one evening sitting on his porch, enjoying a cigar and thinking about all the people who had put in so much time to make it all happen. It dawned on him then that the most important components for the survival of our company were ... the ramp workers, the fuelers, the sorters, the couriers, the clerical staff, the pilots, the assistants, the receptionists, the mechanics, the dispatchers and everyone else who contributed to the process. The fact that it's all show-ed up for work each day and night was *the most important component* as long as that continued to happen, he knew we would be okay.

As Glenn told me that, I realized how much I appreciated everyone who showed up for work all through that long week and weekend. While there were times in management when we worked hard and long hours, we all recognize that comes with the territory. The true gift to the company was the "choice" hundreds of you made in being available, and working different days and different hours than you were normally scheduled for. Thank you, everyone, for helping out in a big and generous way!

Steve Fetter, Vice President, Airline Operations

From: Fries, Mark
Sent: Thursday, September 20, 2001 10:19 AM

I think that the interaction that Jon Powers and Eric DeCoito had with Ameriflight and all of the other charter companies we used was outstanding. Eric and Jon both did well over 30 hours (not once, but twice) of no sleep in the relentless pursuit of customer satisfaction. We ran everything from pistons to DC 9s off of the West Coast, either to CMH or other destinations and we could not have done it as effectively as we did without their help.

A special thanks should also go to **Tony Yousefelahi** in PHX for arranging line hauls from his city to BUR, and two drives to DAL. DAL alone is over 20 hours one way!

Job well done!

From: **Wright, Ken**
Sent: Thursday, September 20, 2001 10:16 AM

I know that two pilots delayed their vacation a couple of days and flew on the weekend. Another pilot drove two hours (each way) from Boston to Hartford to fly when we could not reach a pilot in Hartford.

Another pilot, **Brian Small**, drove three hours (each way) from Birmingham to Atlanta when we could not reach one of the Atlanta pilots. These pilots clearly went way beyond the call of duty.

Scott Jacobs is another. Scott was in Richmond on Tuesday when the disaster happened. Instead of Scott renting a car and coming home when all aircraft were grounded, he rented a truck and transported checks from city to city as needed. He drove continuously from Tuesday through Saturday night, sleeping when he got the chance. Upon arriving Saturday night here in Columbus, he stayed at the hub for about three hours, leaving only because he was coming in early Sunday morning. He apparently took a copy of our weekend routes home with him because when he came in Sunday he knew where all the routes were scheduled and how the system was to run.

Some of the sorters (**Charles O'Dell**, for one) was here for 25 straight hours, catching only a two-hour nap. Others worked 24/7, Tuesday through Sunday night, sleeping when they got a chance. Two that I am aware of were **Jon Powers** in Denver and **Dean McCorkindale** in Dallas. These are just a couple of the unbelievable stories that I am aware of. There are probably another 100 or so stories that I am not aware of.

From: Watson, Mark
Sent: Tuesday, September 18, 2001 10:05 AM

The Air Courier Department would like to thank all of the sorters and pilots who helped us handle the enormous volume of work last Thursday night (9/13) and Friday (9/14) morning. We also want to thank all of our folks in the Express Call Center for doing a terrific job handling the mountain of phone calls from our Air Courier customers. Thanks Team!

From: Ann Mancuso
Sent: Monday, Sept. 17, 2001

Andrea Zarfey, Berniece Estep and Valerie Stocksdale each worked a couple of 12-hour shifts to answer our switchboards, answer questions from our customers, and questions from team members. They were "command central" for anyone with questions regarding work schedules, location of family members, food orders, etc. Many, many thanks to these ladies for their willingness to put in the extra hours needed to keep things organized at the front desk.

From: **Susak, Wendy**
Sent: Thursday, September 20, 2001 1:18 AM

With all due respect, I don't know of anyone who didn't give 110% of themselves physically *and* mentally. I would find it almost impossible to pick just one person. We are a great team and worked like a team, without giving grief or complaint to anyone. I give a vote to ALL of the AirNet team that pulled together as a whole, not only for this company, but for our customers as well.

From: Powers, Jon
Sent: Wednesday, Sept. 19, 2001 12:50 PM

I would like to recognize the following team members for making it happen out west during our national crisis.

APA- for the large hub APA held for the West Coast Flights on Sunday. We were lucky enough to have the folks come in. Otherwise, it would have been only Pete, Amanda and myself to handle the entire hub.

Many thanks to: **Pete Cruser, Amanda Betz, Aaron Mandolesi, Edward Chadburn, Ryan Purvis, Lindsey Sunday and William Kostner**

I would also like to recognize John Hildebrand and Dave Carey from the APA Maintenance Dept. They

did a tremendous job handling the aircraft during the entire hub on Sunday. We were fortunate enough to have them available on Sunday.
BUR - Eric DeCoito, Pat Noiboonsook, Jesse Castellano, Ron Ahue, Chris Brown

SFO/OAK - Dan Hayes and Jan Jennings

PHX - Tony Yousefelahi

I would like to recognize the following individuals for going above and beyond DURING THE CRISIS. I am very proud to have such a devoted group of managers in my region. I know these folks will do whatever it takes to get the job done. They have proven that to me time after time.

Tony Yousefelahi - He scheduled two ground routes to DAL and a ground route to BUR on very short notice to move the volume of work out of the PHX banks (utilizing his I.C.'s). Was ontop of all the charters/ Amerflight coming into and out of his city.

Eric DeCoito - I can't say enough about Eric during this period. He immediately drove to BUR on Wednesday morning, coordinated the loading of the bank work for the DC-9 charter (26,000 lbs. of bank work) that went in/out of ONT. Was on top of the BOA/Wells special charters out of BUR. Was on top of all the Ameriflight charters in and out of BUR. Rented two box trucks to move the L.A. Fed pickup Sat. (3300 lbs.). Coordinated the unloading of the DC-9 when it came back through ONT on Friday. Was always in contact with Ameriflight regarding the charters they flew for us.....and much, much more!!!!

Dan Hayes - Coordinated the pickups and drove the work to Hayward to get loaded onto the Falcon Charter Thursday. Coordinated the 286 unloading in Stockton on Tuesday. The SFO Fed pick-up on Sat (4500 lbs.). Coordinated with Ameriflight on his in/ out charters. Did the special Wells pick-up Saturday morning that went out on a charter. Did the special Wells pick-up on Monday that went out on ANS.

Pete Cruser - He spent days here at the hangar to ensure the planning and routing of the entire APA system. He gave CMH suggestions on what planes and crews to use. He coordinated his Saturday incoming activity. He did a superb job on his Sunday West Coast Hub that was held in APA. We had three different companies flying and 10 different aircraft arrivals, all going to the West Coast cities. Pete spent 16 hours here at the hangar on Sunday to accomplish this and did one heck of a job with moving the work to the outbase cities, in addition to getting his own work delivered.

Once again, I would like to thank all of the pilots/ flight dispatch/loaders/couriers/managers and vendors for doing such a great job during the past week.

Jon P. Powers
Regional Operations Manager

From: **O'Neil, Cheryl**
Sent: Wednesday, September 19, 2001 2:35 PM

Just heard some good news....

One of our customers, Thatcher, Profitt & Wood, had a business in the #2 Tower. We assumed the worst. **Misty Duffy** just received a call from them asking if they could still ship with us. Yeah! What a relief to know they are still with us!

From: **Yousefelahi, Tony**
Sent: Wednesday, September 19, 2001 1:26 PM

I would like to recognize **Tod Walker's** efforts. Despite his age and physical restrictions, Tod, our independent contractor here in Phoenix, has dedicated himself 24/day to help us carry through during this unusual operation. He recognized the complexity of the situation and went above and beyond his duties as an IC to get the job done.

From: **Hunnicutt, Walter**
Sent: Wednesday, September 19, 2001 1:24 PM

Some of our crews got caught in the emergency divert operations. As I understand it the Air Traffic Control Centers simply broadcast something to the effect of, "Guys, terrible things are happening in New York, and you've all got to find some place to go - fast!" That had to be a fairly stressful situation. A special thanks to the flights/crews that had to make that happen.

Back here in the Flight Training department, **Troy Reinfrank, Marshal Fern, John Hughbanks and Jim McGovern** managed to keep our inital trainees on schedule in the simulators. And to a man, the Instructor Pilot team turned out and volunteered for any and all special missions and "lifeguards" they could find. In particular, **Keith Anderson and Dan Vossman** flew blood and medicine through Texas, out to California and all the way back to Columbus in one massive run that didn't get back here until almost 10 am. A full 14 hrs. of duty (10 of flight) on a moment's notice and they both volunteered eagerly.

From: Connelly, Joe
Sent: Wednesday, September 19, 2001 2:17 PM

Some of us in the MIS department went out and helped load trucks on the makeshift sort line. **Craig Leach** was right out there with us, helping to load. **Greg Klopfer** and **Lawrence Carter** even drove to Ocala to load a DC-9 at Rickenbacker A.F.B. We all worked to help AirNet accomplish its goals and to keep operating through all of this.

From: **Simone Baker**
Sent: Wednesday, September 19, 2001 1:02 PM

Last week when the tragedy struck, I think all of us were thrown into a state of chaos, which we are finally starting to climb out of. I know that many people (regional managers, sales staff, airline dispatch, etc.) were hit extremely hard and worked hours above and beyond, leaving their families at home to stay here and help. One such person that comes to my mind is **Cindy Penrose**, Bank Customer Satisfaction Team Leader. She is a single mother of three children, and although she had many responsibilities to attend to at home, she stayed each day an excessive number of hours to make sure our customers were satisfied. Her grandmother passed away the weekend before, and she missed the funeral to be here with us at AirNet. She kept all of us here in Customer Service focused and calm when things got rough, and attended all meetings to continually keep us informed of the situations as they arose. We appreciate Cindy.

From: **Williams, Lori (CMH)**
Sent: Wednesday, September 19, 2001 12:48 PM

I'd very much like to see that the "behind-the-scenes" people get recognized. Many people gave a lot of time to get things done operationally last week, however, we need to remember the billing folks in both Bank and Express — and the entire accounting team who will have to work long hours in the upcoming weeks to untangle all of the "unscanned" items and create invoices so that we can actually get paid for the services we provided.

The supply team is shipping items out via Airborne (which changes the way they perform their duties) and working hard to make sure that the blank airbills are at each location so that operations are not interrupted. They are assessing what can be shipped Airborne and what can wait so that we don't incur a lot of unnecessary expenses. They have been working with operations to find out what could be shipped on the truck system in order to not disrupt our services. In one day, they printed several thousand blank airbills while maintaining the regular print schedule to respond to the urgent station requests.

People may think that just because many of us with office jobs weren't out unloading trucks that we are not committed to the team effort — which is false. I've personally taken many calls from reporters, etc. asking about our operations as well as addressing many insurance requests (due to the tight security at airports). I also expect to get many "reconstruction" and cargo claims in the near future that will require my attention.

From what I've observed, we all pulled together as a TEAM.

From: **O'Neil, Cheryl**
Sent: Wednesday, September 19, 2001 12:55 PM

I would like to commend **Misty Duffy** and **Cathy Thaler** for helping Mark Ferrara at American Banker.

Shortly after the second plane hit we received an e-mail from Mark Ferrara to see if we could get in touch with his wife and let her know that he was fine and heading north (I believe that was the Bronx, but not sure). Frantically, the two ladies kept dialing the phone number but could not get through. Finally, after a couple of hours of trying, Misty was able to reach an answering machine - no name to confirm who she had reached - and left the message, "I don't know if this is the right number, but Mark Ferrara is fine." The next day Misty received another message from Mark saying, "Thank you. You reached the right number and I am home now and my wife is grateful for the call."

From: **Wheeler, Judy (CMH)**
Sent: Wednesday, September 19, 2001 12:34 PM

Bruce Beacom came in early on Friday (9/14) and worked at least one of the sorts over the weekend. Not real sure how much extra time he worked, but I know he had some long difficult days assisting with the re-vamped schedules.

From: **Bob Caponi (TEB)**
Sent: Tuesday, September 18, 2001 1:56 PM

During the crisis, **Luis Laboy** has been here in the TEB office well over his 40 hours, and being that he is on salary he gave up his time to make sure all shipments would go without a problem. On Tuesday, September 11, he stayed for 24 hours because airport operations were letting people leave the airport but no one was allowed to return because

of the events in NYC. Airport security was very jumpy on that day, and rightfully so. On Saturday and Sunday, 9/15 and 9/16, he was here again putting DDR's on bank work coming in to ensure that we would have proof of delivery. I believe that this kind of dedication needs to be applauded.

From: Newman, Dave (CMH)
Sent: Tuesday, September 18, 2001 10:22 AM

I would like to recognize two people in particular who gave of their all during the national crisis.

Steve Moore worked all weekend alerting owners of changes, pushing bins, loading A/C. He went well beyond his normal duties, showing a level of commitment to AirNet that is impressive. He did all this not expecting anything in return.

Steve Kemerling also worked all weekend. He helped with the DC-9 adventure and he also drove to CVG and SDF Sunday morning. Steve, in my opinion, is one of the hardest working people in the company.

Just because I recognized only these two people, in no way do I want to diminish the efforts of the flight dispatch team, pilots, ramp and sorters, ground ops, maintenance, bank ops, customer service, etc. The way in which the entire operations and sales group worked together was impressive.

I am extremely proud of the level of commitment shown by the entire company!!!

From: **Moore, Cyndi (CMH)**
Sent: Tuesday, Sept. 25, 2001 12:40 PM

I cannot come up with "just one" team member who excelled during the crisis. We all worked hard and showed our dedication.

I talked to couriers who had been up for three days. In our department, **Sam Greer** didn't go home for a week and **Paul Greer** put in an 18-hour day. Our department worked around the clock, pounding the keys, trying to get the deliveries in. I know that the Bank customers were extremely happy with how quickly we were able to get their times in.

I would like to recognize my co-workers and the AirNet couriers. I think it would be a very big mistake to single people out. With all the dedication shown by AirNet team members, I would hate to see someone inadvertently left out.

From: **Sue Holt (MEM)**
Sent: Friday, September 14, 2001

On Tuesday, September 11, as we all heard the tragic news of the terrorists attacks on the United States, I started getting phone calls at home from our couriers in MEM. Each one said the same thing, "Call me if I can help in any way." And we did need their help.

When I called **Billy Collins** and **Brad Russell,** the only question asked was, "What time do you need me?" Billy left for BNA at 02:30, taking work from First Express and Brad left for ATL at 00:00 to pick up work coming to MEM and LIT. When Billy and Brad returned to MEM, **Donald Holt, Alandas Sanders, Denise Smith** and I were waiting to sort the work and deliver it.

Through all of the long hours, not one person complained about the volume of work or the strange hours that I called them for their help. Those who have pagers and cell phones kept them on while they were not working so I could call them if I needed them. We worked at very odd hours, sometimes going home for just a few hours and coming right back with very little sleep.

There were times we did nothing but wait... we would wait for a driver or, after we were able to fly again, we would wait for a plane to come in. And these people wrote on their timesheets *only the hours they worked.*

I cannot say enough about our AirNet Family here in MEM. We have a saying, "We are all in this together to make it work for *Everyone.*" Each one pulled together to give a helping hand; not always when we chose to, but as we were needed to get the job done. The AirNet Family in MEM is a family I am PROUD to be a part of.

From: **Jerry Peer**
Sent: Monday, Sept. 17, 2001

I would like to recognize two of my team members who stayed on call all weekend. **Sean Ferrin** and **Mike Mallernee** gave up their time away from home to come in and help when needed. Sean came in Saturday evening and worked all night. Mike came in Sunday afternoon and worked all day. They both are very dedicated and hard workers. I am proud to have them on my team.

From: **Phil McEnany**
Sent: Thursday, September 20, 2001 4:22 PM

Jeff Hall came to CMH on September 11, for what was supposed to be a one-day meeting. He stayed on to assist in planning ground routes, renting trucks and making sure everyone was aware of their unscheduled duties. He worked from 0600 Thursday until 1200 Friday, loading and unloading airplanes and assisting wherever he was needed. The company supplied some shirts for him and he bought some other clothing as the days stretched out. He was a tremendous help.

AirNet's "Life Guard" Flights

In the week following the September 11 attacks on our country, our company was faced with many challenges, not the least of which was the unprecedented closing of the National Air Space (NAS). In the 72 hours that followed the closure, we were able to perform over one dozen "Life Guard" flights transporting much needed blood, medical supplies, and medicines to not only the areas directly affected by the attacks but to other parts of the country which were indirectly impacted. The weekend that followed this was filled with unusual need. Our pilots performed without exception under circumstances that were abnormally stressful and required them to pay unprecedented scrutiny to routing and procedural adherence. At no time was it reported that any pilot had a problem with performing when asked to do so. We have always felt that our pilots are the best trained and consequently, the safest pilots in the business.

The following pilot list represents those who flew either a Life Guard flight during the NAS closure or flew on the weekend, which constitutes "going the extra mile." Our sincere appreciation for the demonstrated commitment and positive attitude displayed during a crisis by each of these pilots:

Keith Anderson	**Jonathan Dye**	**Keith McGeorge**	**Brian Chamness**	**John Millspaugh**	**Tony Crenshaw**
Dan Vossman	**Chris Spence**	**Mitch Ouillette**	**Keith Albro**	**Christian Karnov**	**Jeff Meyer**
Chris Butcher	**Jason Rodela**	**Shawn Morrow**	**Tim Case**	**Brian Small**	**Justin Green**
Jeff Russell	**Matt Goulet**	**Blane Langanke**	**Glenn Dorries**	**Paul Galles**	**Chad Moyer**
Jeff Kleberg	**Jarib Hartman**	**Chad Wright**	**Ed Knapp**	**Donavan Kerr**	**Geoff Zimmerman**
Todd Bole	**Bill Robb**	**George Brock**	**Shawn Reinhart**	**Felix-Albert Desmangles**	**Ben Niemeyer**
Blake Edwards	**Eric Hanft**	**Steve Schell**	**Michael Hammer**	**Walter Hunnicutt**	**Scott Rockrohr**
Randy Dobson	**Alex Koch**	**Glenn Sharp**	**Mark Haley**	**Ian Boyan**	**Tawn Makela**
Joe Seaborn	**Aaron Barnett**	**Liisa Lesser**	**Justin Pirtle**	**Quinn Hamon**	**Paul Wickham**

In the preceding pages, you've read about AirNet camaraderie, "family" and team spirit. Some of us witnessed firsthand the actions of loyalty and com-mitment to our company and our country. As we reflect on the tragedy and our commitment to regaining some semblance of normalcy, we are haunted by the fear that we may have to pull together once again to mend what the terrorists are attempting to sever... our freedom and unity. In closing, I'd like to share a letter from team member Keith Anderson that was sent Monday, September 17. This letter validates all that's been said and felt in the previous pages....

This past week and weekend were rather bittersweet. The bitter part of this experience was the tragic loss of life caused by the terrorists. What a reminder to us that we need to focus on the important things in life such as faith, family and friendships! The sweet part of the experience was seeing our company team pull together to lend a hand to the authorities by flying the "Lifeguard" flights as well as helping our customers by shipping enormous volumes of checks.

I saw the dispatch crews working feverishly throughout the whole process as they put in many long hours to get the job done. It also was neat to see the executive leaders of this company (from Joe Biggerstaff on down) rolling up their sleeves to push bins, unload airplanes, and work shoulder-to-shoulder with the ramp team, not only Thursday night but throughout the weekend. It set a good example for everyone... that we are all in this together. I'm honored to be a part of this team. **Keith Anderson - Pilot**

AirNet Systems, Inc.
3939 International Gateway
Columbus, OH 43219

First 'lifeguard flight' after attacks ships central Ohio blood products

As a result of the tragic events of September 11 all civilian aircraft, including the 117 aircraft fleet of AirNet Express, were ordered out of the air by the Federal Aviation Administration (FAA) on Tuesday morning.

Such an order was unprecedented in American history. The AirNet Express flight dispatchers could visually see the hundreds of airline tracking dots vanish from their aircraft situational display screens as the aircraft cleared the sky, landing at the closest available airports.

Knowing that the Columbus-based AirNet Express could assist in rescue efforts, Vice President of Medical Services Tom Brennan contacted the American Red Cross with an offer to help in any way possible. The American Red Cross advised AirNet Express that there was a need for emergency medical supplies on the East Coast to help with the devastation in New York and Washington, D.C. AirNet Express is one of only a few airlines in the nation authorized to carry radio pharmaceuticals in quantity and routinely carries blood, and other medical equipment and supplies.

After receiving support and approval from the FAA, AirNet Express dispatched a plane piloted by team members Keith McGeorge and Mitch Ouillette to handle the first, "lifeguard flight" granted permission to fly since the closing of the National Air Apace (NAS).

The plane left Columbus, Ohio, at 3:37 p.m., at a time when air traffic would normally be high, both pilots commented about how quiet it was in the sky. No other call signs were on the airwaves.

Keith and Mitch found out first had how tight security was in the air. While in flight, they were contacted by Air Traffic Control and told not be alarmed if two military jet escorts appeared as a precautionary measure --which happened within 30 seconds. Other than that, the flight was uneventful and AirNet Express was able to deliver the needed supplies within hours.

America's Fund for Afghan Children

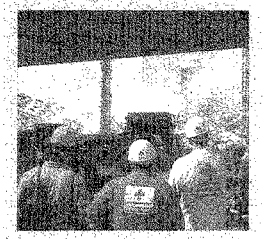
President Bush issued a call to action to children across America on Thursday, Oct.11, asking each child to put a dollar in an envelope and send it to the White House in support of the more than 10 million children in Afghanistan.

The American Red Cross will be responsible for both administering the funds and developing relief programs to improve the lives of children and their impoverished families who are mired in an extended humanitarian crisis.

"Children across America can help their peers in a country of innocent children who have gone without for so many years," said American Red Cross President and CEO Dr. Bernadine Healy. "The donations provided by generous

vital statistics

American Red Cross response to terrorist attacks



Through the generosity of the American people, the American Red Cross continues to serve the nation as it grieves from the September 11 terrorist attacks. The following vital statistics were compiled the third week in October.

Emergency Gifts Total:
$28,861,365

Blood Donations Total:
1,000,282 units

Amount Raised:
$500 million

Mental Health Contacts:
109,507 Cases

Call center for friends and family directly affected by attack, 866 GET INFO:
8,010 Calls

Meals/Snacks Served:
7,226,038

Disaster Workers (staff and volunteers):
40,441 total

Volunteers:
38,696 of above total

WRITTEN STATEMENT OF
THE ASSOCIATION OF CORPORATE CREDIT UNIONS
ON THE CHECK CLEARING FOR THE 21ST CENTURY ACT
PRESENTED TO THE FINANCIAL INSTITUTIONS AND CONSUMER CREDIT SUBCOMMITTEE
OF THE HOUSE FINANCIAL SERVICES COMMITTEE
SEPTEMBER 25, 2002

On behalf of the Association of Corporate Credit Unions (ACCU), this statement is submitted as part of the record for the September 25, 2002, hearing on the Check Clearing for the 21st Century Act (the Act). ACCU serves as the primary trade association for the thirty-three corporate credit unions (corporates) located around the country, which provide liquidity, investment products, payments settlement and other financial services to their member-owners, the nation's 10,300 federal and state-chartered credit unions.

ACCU commends Chairman Bachus for holding this hearing and Representatives Michael Ferguson and Harold Ford, Jr., for introducing this bill to the Congress. ACCU also applauds the efforts of the staff of the Federal Reserve Board in crafting this legislation with significant input from consumer groups, all sectors of the financial services industry, and other interested parties.

As noted above, corporates provide extensive payments settlement services to the nation's credit unions. The majority of corporates offer item-processing services to their member credit unions. All corporates that offer item-processing services truncate items, and many corporates have implemented the most advanced imaging technology available. The credit union industry has embraced check truncation for over 20 years. Credit unions have found that check truncation, under existing check law, allows credit unions to provide outstanding member service and to lower applicable checking fees.

The experience of corporates is that their credit union members rarely receive requests from consumers for originals from truncated checks. Last year, corporates processed over 1.1 billion items in total check volume. Of those 1.1 billion checks, only about 480,000 requests are made for the original check (.04%) and in almost all cases, the corporate credit union could make a good-quality, clear image of the check that satisfied a member's needs.

ACCU supports the Check Clearing for the 21st Century Act and encourages this subcommittee to consider its adoption. ACCU applauds the Federal Reserve's efforts to improve the acceptance of check truncation through this legislation, which encourages truncation without requiring all institutions to receive checks in electronic form. This Act would hasten efficiency in the payments system and allow existing truncation programs, such as those at credit unions, to coexist. ACCU believes this legislation provides flexibility to allow credit unions make their own business decisions about truncation and about how they want to handle and process deposited items.

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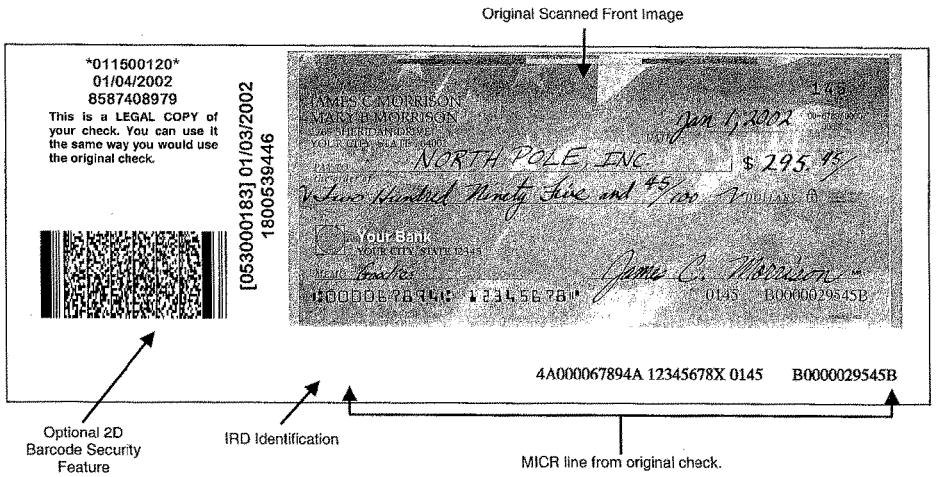
The Act would permit depository institutions to convert original checks into electronic items and send those electronic checks to other depository institutions that agree to accept electronic checks. If a depository institution does not agree to accept electronic checks, then the originating depository institution would send that institution a substitute, paper-machine-readable copy of the check (a substitute check). During the collection and return process, checks would be converted into electronic and paper versions as necessary. ACCU maintains that the Act is certainly a much needed step in the right direction of evolving the payments system to a point that recognizes the ability of a financial institution to present an item totally electronically without the need for previously adopted agreements. ACCU also believes this legislation strikes an appropriate balance in promoting the efficiency, effectiveness and fairness of the payment systems, but not at the expense of the consumer. The Act certainly forms the basis for a reduction in processing costs, along with the potential for accelerating the collection and related return processes, results which are beneficial to all parties within the payments process.

In conclusion, ACCU believes that the principles embodied in the Check Clearing for the 21st Century Act are essential to the evolution of the payments system and enhancing the system's efficiencies. ACCU looks forward to continuing its work with this subcommittee, the Federal Reserve Board, consumer groups, and others on this legislation.

DRAFT - Original IRD of Personal-Sized Check, Front



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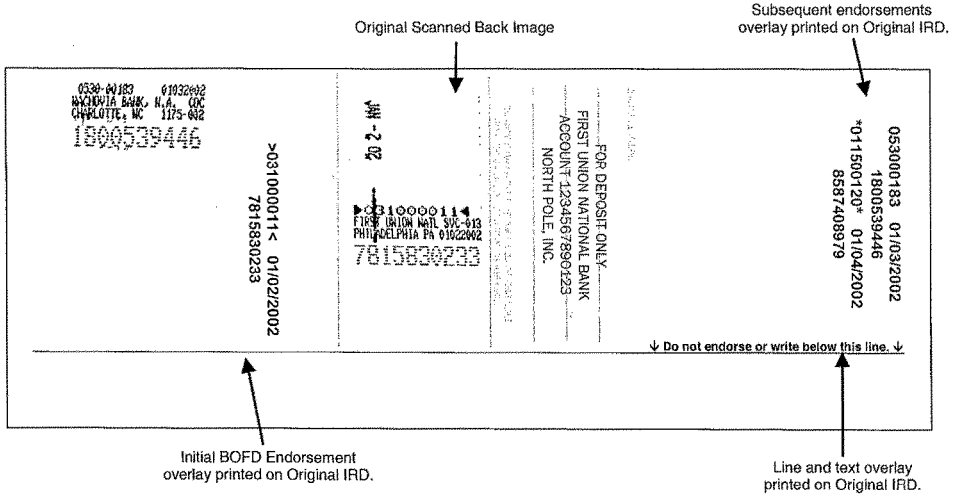
DRAFT - Original IRD of Personal-Sized Check, Back



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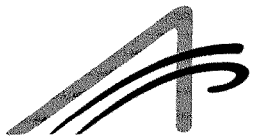

Association for Financial Professionals

Statement of the

Association for Financial Professionals

to the

U.S. House of Representatives
Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit
Representative Spencer Bachus (R-AL), Chairman

For the Record of the Hearing on

Check Clearing for the 21st Century Act (H.R. 5414)

September 25, 2002

STATEMENT OF THE ASSOCIATION FOR FINANCIAL PROFESSIONALS TO THE UNITED STATES HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT REPRESENTATIVE SPENCER BACHUS (R-AL), CHAIR FOR THE RECORD OF THE HEARING ON CHECK CLEARING FOR THE 21st CENTURY ACT (H.R. 5414) SEPTEMBER 25, 2002

Mr. Chairman and members of the Subcommittee on Financial Institutions and Consumer Credit, the Association for Financial Professionals (AFP) welcomes this opportunity to submit a statement for the record of the hearing on the Check Clearing for the 21st Century Act (H.R. 5414), held on September 25, 2002.

AFP represents approximately 14,000 treasury and finance professionals who, on behalf of over 5,000 corporations and other organizations, are significant participants in the nation's payments system. Organizations represented by our members are drawn generally from the Fortune 1,000 and the largest middle market companies. Many of AFP's members have direct responsibility for check disbursements, collections, reconciliation, and fund transfers generally. AFP members' companies, with their higher check volume, larger check amounts and greater exposure to fraud, have a sizable interest and significant stake in the advancement of measures to improve the efficiency and safety of the payments system.

AFP has been a strong advocate of the federal government's efforts to migrate from checks to electronic payments. We cooperated with the government to develop and implement the Electronic Federal Tax Payment System that enables businesses to pay their federal tax deposits electronically. We supported EFT 99, the legislative mandate requiring the government to make disbursements electronically. And we actively participated in discussions with the Federal Reserve Board during the drafting of the Check Clearing for the 21st Century Act, or Check 21.

Check 21 is designed to foster innovation in the check collection system without mandating the receipt of checks in electronic form. It would do this by removing the legal impediments to check truncation. The bill would permit machine-readable paper copies of checks, called substitute checks, to replace original checks in the clearing and return process. In drafting the law, the Federal Reserve sought to ensure "that a bank and its customer would be in the substantially equivalent legal and practical position regardless of whether or not they received the original check." The proposed legislation would encourage banks to eliminate paper from the check system at the earliest possible point in the process. This would increase the efficiency of the check system, cut costs and improve availability. Given the continued predominance of checks as the primary payment method in the U.S., the resulting increase in productivity should bring substantial benefits to the economy.

AFP supports the concepts underlying Check 21 and understands the benefits of replacing original checks with check images. However, we believe that there are several provisions in the

Act as currently drafted that, if not corrected, would lead to unintended consequences in some cases while allowing other barriers to check truncation to remain standing. They are:

- Linking all duties, obligations, and protections under Check 21 only to items that meet the four-part test of a "substitute check," while leaving purported substitute checks that suffer from a technical defect in an uncertain legal position.

- Omitting electronic images of checks—digitized reproductions of the original checks—from the scope of the Act, at least for purposes of legal equivalency. Their inclusion under the Act would eliminate uncertainty regarding the acceptability of electronic images in contract disputes where payments are involved and thereby advance the adoption of electronics in check processing.

We will also point out other drafting issues that should be clarified.

Linking of Duties, Obligations and Protections Only to "Substitute Checks" as Defined

We believe that a bank is obligated to ensure that a substitute check qualifies as a "substitute check" under the multi-part test of Section 2(17). When there are defects that prevent an item from meeting the definition of a "substitute check," a paying bank would be under no obligation to accept it under Section 3(a) and the original check would have to be presented. However, an item may be created and handled with the intention that it be treated as a substitute check, but the item may ultimately suffer from a defect that prevents it from being a "substitute check" under the Act. For example, a bank may have encoded the MICR line sufficiently for the item to be processed, but may have failed to encode "all" of the required MICR line information generally applicable under industry standards as required under Section 2(17)(B).

Such an item would not appear to be afforded the legal equivalency protections of Section 3(b),[1] nor would the warranties and indemnities of Sections 4 and 5 seem to apply under this circumstance because all of these provisions apply literally only to checks that are actual substitute checks as defined. The same is true of the consumer protections in Section 6. Damages may not be recoverable under Section 8 because there may not be an actual breach of a warranty since the warranties are linked to "substitute checks." In short, we recommend that the Act be amended so that all of the duties, obligations and protections that arise under the Act apply to "substitute checks" as defined and to items which are presented and handled with the intent that they be treated as substitute checks under the Act.

[1] The legal equivalency protections of Section 3(b) rely not only on an item being a "substitute check;" the item must also meet two additional tests in order to gain these protections—be an accurate representation of the truncated original and bear a certain legend. While we understand the theory behind the accurate representation requirement, we are concerned that a court may hold that the original check must be presented to be able to determine if the substitute check "accurately represents" the original check at the time of truncation. We also believe that the bank should have an affirmative obligation to affix the Section 3(b)(2) legend on the substitute check.

Inclusion of Electronic Check Images

Electronic images of original checks were included within the scope of the Act during the drafting stage, but were subsequently omitted.[2] The Federal Reserve's section-by-section analysis of the revised version submitted to Congress stated that the Federal Reserve favors excluding electronic checks from the proposed Act's scope because that would allow "the banking industry to address liability and technical issues related to electronic exchanges through agreements" which the Federal Reserve believes is preferable. However, while such agreements can successfully address many liability and technical issues, they cannot solve issues surrounding the "legal equivalency" of electronic check images. For this reason, AFP recommends that electronic images of checks be included in coverage under the Act in so far as their legal equivalency is concerned.

As the Federal Reserve points out, banks today exchange electronic check information and images under bilateral or multilateral agreements with each other and by agreement with their customers, including many major companies. This may be an agreement between banks engaging in electronic presentment of check images or information describing checks under U.C.C. Section 4-110(a), or an agreement between a bank and its customer providing that, regardless of whether original checks or images are presented for payment, only images will be supplied to the customer under Section 4-406(b).

However, companies that receive electronic images of checks are not "in the substantially equivalent legal and practical position regardless of whether or not they received the original check," which is one of the Federal Reserve's stated objectives in promoting Check 21. If companies continue to be exposed to legal uncertainties regarding the acceptability of electronic check images in a court of law, their acceptance and use of electronics in the check clearing process will be undermined and the Federal Reserve's efforts to facilitate check truncation and foster innovation would be considerably hampered.

The original draft produced by the Federal Reserve solved this problem by providing legal equivalency for "electronic checks," meaning both images of original checks that passed normally through the collection chain and the new form of substitute checks. With the omission from the scope of the Act of provisions relating to electronic checks, there can be no assurance that electronic images would not be precluded from acceptance in court under state evidence laws. Such preclusion could bar an attempt by a payor to prove payment by the introduction of the image of a truncated check or by a payee to prove that a truncated check was returned by the payor bank.

[2] The Federal Reserve's original February 2001 draft used the term "electronic check" throughout the text, and it was defined as meaning "a digitized reproduction of an original check or a substitute check."

AFP is concerned that the Uniform Electronic Transactions Act (UETA) and the federal E-Sign Act do not definitively provide that electronic check images satisfy the various state rules of evidence in cases of contract disputes where payments are involved. Those Acts state that if a statute, regulation, or other rule of law requires the retention of a check, that requirement can be satisfied by retaining an electronic record.[3] Both laws also state, however, that their respective terms do not apply to transactions governed by, among other things, Articles 3 and 4 of the U.C.C. on check processing.[4] As the Federal Reserve affirmed in its analysis of the Act, "both E-Sign and UETA by their terms affect only rules requiring the retention of paid checks, such as for recordkeeping or audit purposes, and do not create electronic or substitute payment instruments."

In a payment dispute, a party may object to an electronic image of a paid, original check and claim that E-Sign may not be relied upon for its introduction since there is no law at issue which requires the retention of the check for such purposes. By firmly stating the legal equivalency doctrine for all check images here, as was done in the original draft, a bank customer is not left to the vagaries of state laws and evidence rules for whether an image of a check sent to it by its bank may be used for all purposes.

Benefits of legal equivalency for "electronic checks"

To close this gap and clarify check law as it applies to truncation, AFP recommends the limited reintroduction to the Act of legal equivalency protections for "electronic checks." This will eliminate the legal uncertainty to which companies involved in contract disputes may be exposed, enable banks and their customers who receive electronic images "to be in substantially the same legal and practical position regardless of whether or not they received the original check," and promote the acceptance of check truncation. The Federal Reserve states that today less than one-quarter of checks are presented electronically. Much work needs to be done to increase that number. Eliminating the legal uncertainty surrounding electronic images will speed that effort, especially among companies that write a significant volume of the nation's checks. Such a limited reintroduction furthers the Act's purposes without changing any existing laws, for example, surrounding warranties and recrediting rights for such items, which are adequately addressed under U.C.C. Articles 3 and 4 and need only be covered in the Act for the new class of "substitute checks."

Other Drafting Issues

Section 12 broadly provides that only Section 7 may be varied by agreement. While this should be sufficient to avoid a disclaimer of the warranties, indemnities and other protections of Sections 4 and 5, typically such provisions expressly provide that their terms cannot be

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[3] For example, see Section 101(d)(4) of E-Sign.

[4] For example, see Section 103(a)(3) of E-Sign.

disclaimed. For example, the various check warranties and corresponding indemnities contained in U.C.C. Sections 3-416, 3-417, 4-207 and 4-208 all provide that their provisions "cannot be disclaimed with respect to checks . . . ." In the interest of not drawing any unfavorable inferences by excluding such a provision from this Act, we recommend that similar language be added.

Finally, H.R. 5414, as reported, does not appear to contain an actual definition of "customer" in Section 2(10). The term is used extensively in Section 10 regarding the Federal Reserve's duty to prepare an educational document on substitute checks and banks' duties to distribute the document to "each existing and potential customer of the bank" (emphasis added). We are unclear whether commercial and consumer customers are intended to be covered or just consumer customers.[5] At a minimum, it would make sense to limit coverage to existing and new (as opposed to "potential") customers with accounts that can be accessed by checks. Since much of a bank's compliance costs are passed on to its customers, at least indirectly, we do not believe that an overly broad notice requirement is in the public's interest.

Recommendations

AFP supports legislation that would improve the efficiency of the payments system and facilitate check truncation by authorizing substitute checks as the legal equivalent of the original check. We urge the House to improve the Check 21 Act by:

- Extending the duties, obligations, and protections of the Act to items which are processed as substitute checks even if they do not meet all of the Act's technical requirements;
- Including electronic images of checks within the scope of the Act for purposes of legal equivalency, in order to eliminate uncertainty regarding the acceptability of electronic check images in contract disputes where payments are involved and thereby to advance the adoption of electronics in check processing; and
- Clarifying certain other drafting issues.

The Association thanks the Subcommittee for this opportunity to comment on the Check 21 Act.

[5] We note that the document is required to discuss, among other topics, the protections of Section 6 that apply only to consumers.

WRITTEN STATEMENT BY

GREGORY J. YU

OF

CHEN-YU ENTERPRISES LLC

SUBMITTED TO THE

HOUSE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

SEPTEMBER 25, 2002

WRITTEN STATEMENT BY GREGORY J. YU OF CHEN-YU ENTERPRISES LLC

SUBMITTED TO

THE HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON

FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

SEPTEMBER 25, 2002

Chen-Yu Enterprises, LLC ("CYE") presents this submission regarding proposed H.R. 5414, known as the "Check Clearing for the 21st Century Act" (the "Act"). Gregory J. Yu, Marketing Director and Chief Legal Officer of CYE, is principally engaged in business development for CYE's proprietary solutions for payments processing, check imaging, and data warehousing. Attached as Exhibit A is the *curriculum vitae* of Gregory J. Yu; and attached as Exhibit B is a disclosure statement pursuant to Rule 3 of the House Committee Rules.

INTRODUCTION

The Expedited Funds Availability Act previously vested the Federal Reserve Board of Governors to regulate the functioning of the check payments system. In that vein, the Federal Reserve in May 2002 launched FedImage Services® for participating commercial banks. The message is that the newly available image management services "can improve your cash management information flows, achieve more efficient accounting and processing functions, enhance your check fraud reduction efforts and potentially increase revenues." Already, the market for check processing and imaging services is expanding as banks not only gain new efficiencies but also take full advantage of processing and customer data collection off the check image for various applications.

The Act explicitly aims to "foster innovation in the check collection system without mandating receipt of checks in electronic form." H.R. 5414 leverages new technologies but should not necessarily stop at increasing efficiencies but enhance the data gathering process for banks, government and ultimately for customers. H.R. 5414 can simultaneously achieve that goal while streamlining check electronification.

The Act should be careful not to evolve into an unfunded federal mandate, whereby the industry as a whole and banks individually spend unpredictable sums to secure scalable check image capture and exchange capabilities. All banks would face the reality of either (1) accepting, in the long term, substitute checks for themselves and for their customers or (2) investing in or outsourcing of check image capture capability, followed by effecting numerous truncation agreements with other banks.

CYE SOLUTIONS FOR THE INDUSTRY

CYE's technology and products fill a unique role in innovating the payments processing industry. These solutions covering check and credit/debit card payments electronically tag consumer and business payments with a major category of outlay. For example, consumer payments fall into standard categories as clothing, mortgage/rent, food, utilities, medical, dependent care, education, investment, donations, etc.; business payments divide into universal

groups such as rent, phone, payroll, inventory, fixed assets, taxes, advertising, etc. The bank as the enterprise would process and summarize these payments periodically. Its customer gains a newly acquired tool for budgeting, tax deduction capture, and longer term financial planning/savings. CYE's offers to the market a U.S. patented check (Check*flo*™) that pre-prints these standard categories aligned with bubbles arrayed in the lower left corner of the check (similar to answers to a standardized test). Attached as Exhibit C is a sample. This content replaces the "Re" or "For" line of a physical check. The customer marks (manually or electronically) the bubble for the chosen category at the point of tendering payment to the payee. CYE's software recognition engines are to be lodged at the retail point of sale, depository bank (branch or central capture site), collecting bank (such as the Fed), paying bank, or even an outsourced location after the bank customer has received its canceled physical checks. The standard software reads the original source document (i.e., the physical check) and stores the image. Alternatively, the customer-chosen category is derived from a pre-scrubbed, fully decompressed check image (or at least the snippet with the relevant Check*flo*™ region) that has been faithfully preserved during the check clearing and check truncation processes. Ultimately, the customer's spending summary appears in a printed form or in an Internet-deliverable format. The product is always subject to the customer's consent for any given payment -- without a mark, the bank cannot categorize that payment. Check*flo*™ is currently being tested by a state-chartered commercial bank in the Fed's 12th District.[1] CYE has been developing Check*flo*™ and other solutions in its suite of products for over 10 years, with new patents now pending. One of those pending is the aggregation (and depersonalization with proper filters) of this spending data to allow government agencies to better gauge and project consumer and business spending and associated macroeconomic indicators.

SUMMARY OF CYE CONCERNS

CYE is dedicated to offer its technology to the industry and the government to create, capture and deliver spending data from payment channels to the customer. To this end, CYE believes that H.R. 5414 should insure that:

A. Paying banks, on behalf of their customers, have ongoing access to the original paid paper checks or faithful images thereof so that data capture and security protections are not arbitrarily compromised without compensation.

B. Check issuers are not overtly or incidentally discouraged from using paper checks to tender payment, particularly when they await timely return of important data from the original document.

ORIGINAL CHECKS, SUBSTITUTE CHECKS, AND IMAGES SHOULD CO-EXIST

Priorities are balanced as and when the reduction in item processing costs are measured against the collateral effects on check usage and reliability. Check truncation reduces costs for depositary banks and collecting banks. If these banks are to accelerate their credits, the most

[1] CYE is also engaged in consumer direct sale of its printed retail Check*flo*™ checks, and its customers include those of larger banks, including BofA, Wells Fargo, and Washington Mutual (these institutions have not endorsed the product).

efficient means sends MICR line data electronically (and nothing more) to the paying bank.[2] However, at least in this component of check clearing, paying banks and their respective customers look to authenticity and funds availability. The integrity of the source document, its image and its MICR line and their timely delivery are just as crucial to the paying bank and, indeed, to the health of the overall payments process. Customers too have an important interest in the checks themselves least under existing state law. UCC § 4-406 provides, "if the items are not returned to the customer, the person retaining the items shall either retain the items or, if the items are destroyed, maintain the capacity to furnish legible copies of the items until the expiration of seven years after receipt of the items." Therefore, since commercial banks carry the dual roles of depositary bank and paying bank, the creation of a new commercial instrument should contemplate both sets of interests and benefits. To do otherwise would overstate the net savings in store for banks and the payments industry as a whole.

Like H.R. 5414, Check*flo*™ embraces proven technology to capture, preserve, and transmit check images and data. For example, like banks and other imaging solutions Check*flo*™ faces the daunting task of accurately reading a check's physical and image content, as the case may be. Scales of volume and exceptions processing must be addressed. The substitute check, if not governed by the strictest of guidelines in design, creation, and storage, pose a host of new challenges in the imaging environment. If a single check goes through multiple generations of substitute checks (with increasingly distorted and reduced images), the data capture solution fast exceeds the reach of even the best technology. No benchmarking is really necessary when momentarily picturing a serially faxed letter. More importantly, as banks of various sizes adopt our solution, they face the same deficiency of lacking a proper source document or image to deliver data and reports to their customers. In theory and in practice, the proposal may eliminate a clear choice today for the check issuer. H.R. 5414 does not mandate receipt of a check in electronic form, but it does mandate the receipt of a substitute check that carries the legal boilerplate. Ultimately, the check writer, whether a large corporation, a small business owner or a consumer, cannot be assured that their bank will return of all of their original physical checks. (Interestingly, only Treasury would be exempt.) Since the paying bank and the check issuer cannot be assured of a truncation agreement or the return of the physical (as opposed to substitute) check by the depositary bank or the collecting bank, this form of document control is lost, perhaps permanently.

Furthermore, the substitute check as defined in generalized terms under H.R. 5414 creates clearly foreseeable dangers, and particularly when it arrives from the last of the reconverting banks for a given payment. Today, up to 11 *physical* security features are imbedded inside certain paper checks, including the feature of controlled paper stock. Not surprisingly, those features are requested by check issuers, which include the largest of corporations. Banks do not examine every check, but larger-dollar amount items are selected for sight review or signature verification. One of these features is controlled paper. Thus, even if there is no actual examination of each item, the forger is less likely to be tempted when items are under periodic review. Thus, site review presents a disparity among banks under H.R. 5414. Here, a paying bank normally exercising established risk management procedures against check fraud would now be subject to an arbitrary decision of a reconverting bank to withhold the

[2] Today, this already happens with retail check "conversion" where the paper check is tendered and cleared electronically right at the check-out stand, followed by its immediate return to the customer. Approximately 1 of 2000 checks in the U.S. are paid this way. This, however, is far different from pure electronification because with check conversion, the bank customer has given its clear consent to have the item paid in this manner.

original item and send a substitute. This surely cannot be the true intent of H.R. 5414. In fact, one respected industry consortium is already exploring means to replicate and digitalize certain security features that are lost as original paper checks are replaced by substitute checks. The CYE solution to deliver accurate, customer-initiated categorization of their check spending would be compromised with a greater incidence of fraud.

If consumers and small businesses tag their checks with standard spending categories (whether with our system or any other), rules-based technology now applied to commercial checks can combat fraud in retail accounts as well. Here, the paying bank analyzes spending patterns in checking accounts to flag unusual and potentially fraudulent items. Just as larger corporate accounts can reveal patterns, retail accounts with categorized payments likewise can show patterns. The traditional anti-fraud method, signature verification, is unsatisfactory when larger check volumes and stale signature cards challenge internal bank operations. Rules-based technology for retail accounts could partially compensate for the loss of check review of paper-stock security features not contained in the substitute check.

H.R. 5414 may properly institutionalize the policy and principle of check truncation and reserve the greater technical challenges behind this legislation to the technologists and standardization committees. However, since these committees do not and cannot address the specter of uneven impact on various banks and a wide variety of customers, H.R. 5414 should include greater risk and cost allocation guidelines to overcome potential inequities and ambiguities.

THE UTILITY OF THE PAPER CHECK CHANNEL SHOULD BE MAXIMIZED

For American businesses and households, the paper check is remarkably resilient because of ongoing customer preferences. All channels, whether paper-driven or electronic, are subject to fraud and disruption of service, and there must be alternatives. Just as the private industry has generally acknowledged that a multi-channel (if not channel-neutral) delivery strategy best suits their customers, H.R. 5414 should follow that same approach.

The unexpected blend of substitute checks and original physical checks could generate new lines of exceptions processing for banks of all sizes. Over 7,000 banks and their respective staff would have to be educated and prepared to accept and handle images and substitute checks, even if they were presented with just a handful of substitute checks each year. The benefits and burdens would be unevenly distributed. Depositary banks with advanced imaging capabilities could, under H.R. 5414, compel paying banks and their customers to legally accept substitute checks. Or, while much less likely, those banks could levy a heavy premium on all those paying banks and their customers who require or request the return of physical paper checks. This could suppress the use and indeed desirability of checks drawn on non-"image ready" paying banks. Therefore, to curtail a discriminatory impact against the quality of certain checking accounts, H.R. 5414 should consider having the Fed establish price ceilings for these exceptional requests.

One of the fundamental yet practical values of the paper check is that nearly all customers, on occasion, face the need or desire to view one or many of their checks. This may be a manual inspection of the original. H.R. 5414 allows a reconverting bank to unilaterally destroy the original check (or at least create a substitute check). Viewing the substitute for most bank customers would be turning to the Web. With the return of physical paper checks for

viewing, there is no socioeconomic division. But the paradigm shift to Web check image delivery and preferred pricing represents another unwelcome "digital divide" among Americans. For some, the lack of personal Web access and the lack of high-speed Web access causes extraordinary download times of data-rich check images, inconvenience, and possible loss of privacy in using public access points.

In addition, H.R. 5414 leaves the door open to new fees charged without a clearly matching benefit or service to customers. Banks commonly rely on stratified subsidies, and counter-subsidies to steer consumer behavior. On their face, these tools do not offend fairness, particularly where options remain. Nonetheless, banks as fiduciaries of customer deposits should allow every reasonable convenience and choice in using and transferring funds. For every exception from the standard substitute check exchanged among banks, customers could face initial and recurring fees to receive their actual check as opposed to a substitute check or an image.

Finally, Congress should candidly assess whether reducing usage of paper checks *by the consumer herself* is a decided impact of certain components of H.R. 5414. The paper check, when reviewed, collected and forwarded, provides key values and functions that should not be removed solely based on a business decision of an intermediary bank. Although paper check affinity does not seem rational or measurable to some, H.R. 5414 should not necessarily question the extraordinary confidence economic units still place in the paper check, just as in the tender of currency itself.

CONCLUSION

Overall, CYE's mission is not to protect checks in paper form no matter the cost. Instead, our solutions represent the interests of businesses and consumers as bank customers. Checkflo™ derives useful, timely data from the original physical check or from a faithful, full-scale image, and delivers it back to the check writer. This is no less important for the smallest of remittances of funds originally entrusted to the bank by a consumer.

RECOMMENDATIONS

1. Create a physical, universally accessible physical repository of all original checks and reconverted substitute checks that have been previously truncated, with the cost to be shared among the industry, based perhaps on the volume of substitute checks created by such banks.

2. Establish a ready industry-wide image archive of full-scale original check images of previously truncated and substituted checks, which is accessible by paying banks, their customers, authorized technology providers, and authorized outsourcing firms.

3. Research and identify new methods of fraud detection to respond to the infusion of substitute checks into the clearing process, followed by a periodic report presented to an oversight committee on the impact of the substitute check on key segments of banks and customers.

4. Allow consumers with limited or lower speed Internet access to view their check images through 24x7 channels, such as automatic teller machines, where original check return imposes an undue hardship based on the account balance.

5. Append a provision in the "Consumer Awareness" section to provide a notice to consumers of the possibility that they may face additional fees if requests are made for original checks in lieu of their substitute checks.