

### ***Applying the Concept: Paper Checks Become Digital Images***

For at least 30 years, there have been predictions that paper checks would disappear. Credit cards, ATM machines, debit cards, automatic bill payment, and internet banking were all supposed to get rid of them. Instead, each month millions of households would receive thick envelopes from their banks that included cancelled checks along with their monthly statements. They accounted for 60 percent of payments in 2000. But no more! On October 28, 2004 this all changed. That's when Check 21 – the Check Clearing for the 21<sup>st</sup> Century Act – went into effect.

Banks are thrilled. Until the fall of 2004, the check verification and payment process required commercial banks to transport all paper checks to and from a Federal Reserve Bank, and eventually back to the people who wrote them. The problem was that paper checks were legal proof of payment, so customers wanted them back. But transporting tons and tons of checks around the country was an expensive headache for banks.

Check 21 gives banks the leeway to process checks electronically. Instead of shipping paper across the country, they can transmit digital images of each check that was written. These images create “substitute checks,” and they have the same legal standing as the original checks themselves.

That means that payments in long-distance transactions are much less complicated. Before Check 21, if someone living in Houston sent a check to make a payment to a business in Chicago, the piece of paper had to go from Texas to Illinois, and then back again. Now, the check can be scanned and shredded in Chicago, and the image is saved and transmitted. If the person who wrote it in Houston wants a paper copy of the canceled check, their bank can print a substitute check. A system that used to take a few days now takes a few hours.

This is one of those cases where electronic is definitely cheaper. Experts estimate that by scanning checks and transmitting the images, banks will save \$2 billion a year. These savings include \$250 million spent on courier services to move checks around the country.

In fact, reducing the risks of physically transporting checks was one of the big reasons for the passage of Check 21. For several days following the September 11, 2001 terrorist attacks, only military planes were allowed to fly in U.S. airspace. Among other things, this disrupted the check transportation system eventually grounding \$47 billion worth of paper checks.

Speeding up paper check processing does have one downside: People can't write checks with the expectation that they will have a day or two to make a deposit to cover it. There is no more float. The new rules shrink the time between when a check is written and when the account is debited, especially for out-of-town checks.

By speeding up the processing of paper checks, Check 21 provides a further incentive for individuals to use debt cards, credit cards, or other forms of electronic payments. As digital imaging takes over, we may finally see the demise of paper checks.

For more details on Check 21, payments system development and policies, see the Federal Reserve Board's payment system website <http://www.federalreserve.gov/paymentsys.htm>.

