

Check 21 Issue Brief – Consumer Protections Under U.S. Check Law

This document has been prepared to summarize the application of consumer protections to original checks, check images and substitute checks under both traditional check law and the provisions of the Check Clearing for the 21st Century Act (“Check 21 Act”). This document is for discussion purposes only, and nothing in this document should be viewed as a legal opinion or other legal advice to any person. An organization should consult with its legal counsel on any questions that it may have on issues discussed in this document or under the Check 21 Act generally.

1. Does the Check 21 Act reduce the traditional consumer protections that apply to all checks – including original paper checks, check images, and substitute checks?

No. The same federal and state check laws that protect a consumer today against unauthorized, erroneous, or fraudulent check payments will continue to apply after the effective date of the Check 21 Act (October 28, 2004). These consumer protections for checks apply to consumers regardless of whether they receive back from their bank (as evidence of a paid check) the original paper check, a substitute check, a check image, or an account statement with a description of a paid check.

2. What are the consumer protections under traditional check law that are applicable to all checks, including original paper checks, check images, and substitute checks?

In general, a consumer is protected under the Uniform Commercial Code (“UCC”) in every state against losses arising from: (a) a check that was not authorized by the customer, (b) a check that was paid by the paying bank in a manner not in accordance with the customer agreement, (c) a stolen or lost check containing a fraudulent indorsement, (d) a duplicate check, including a duplicate of a previously presented substitute check or check image, (e) a check that contains fraudulent or altered amounts or signatures, including a forged drawer customer’s signature, or (f) a check that is erroneously encoded during the check collection process with the wrong dollar amount in the MICR line.

These above consumer protections apply to all forms of a check – original paper checks, check images, substitute checks, and line item information on an account statement describing paid checks. Different laws use different terms, but whether it is called a recredit, a refund, or stated in some other fashion, the bottom line is that consumers generally are not responsible for check transactions they did not authorize.

3. How do consumers exercise these traditional check consumer protections?

To exercise these consumer protections, consumers contact their bank to make an inquiry regarding a check payment or allege a dispute regarding a check payment. While there is no mandated, specified time period for the bank to resolve a check dispute, banks typically investigate and resolve these disputes expeditiously. Banks are motivated to resolve check disputes quickly because: (a) they compete with other banks on the basis of customer service, and (b) they may be liable for significant damages if other checks bounce because the customer's claim was valid and the money was not yet refunded. Once the bank completes its investigation of a customer's check dispute, the bank either refunds the amount in dispute or informs the customer why the dispute is not valid.

There have been relatively few complaints from consumers that check disputes are not resolved in a timely fashion. Checks continue to be a popular payment method for consumers, and this popularity reflects consumers' experience with checks and their confidence in the banking industry to complete the check payment and to resolve any inquiries or disputes in an appropriate and timely fashion.

4. What special consumer protections does Check 21 Act contain?

Under the Check 21 Act, the bank providing a substitute check to a consumer customer warrants (that is, makes assurances) to the customer that the substitute check meets all requirements for "legal equivalence" under the Check 21 Act and that there will not be a second debit to the consumer's account arising from the same substitute check. The Check 21 Act also provides protection for consumers against any loss that may occur as a result of their receipt of a substitute check, instead of the original check.

The Check 21 Act also provides a specific process, referred to as the "expedited recredit process" for consumers to assert that a substitute check they received back from the bank was not properly charged to their account and the original check is necessary to show whether the claim is valid. The bank usually must investigate the consumer's allegation within 10 days, or provide a recredit of the amount of the disputed check (up to \$2500) pending the completion of the bank's investigation of the consumer's allegation.

5. Why does the Check 21 Act include additional special consumer protections for consumers when traditional consumer protections for check transactions already apply?

During the consideration of the Check 21 Act, Congress felt that special expedited recredit rights may be appropriate with respect to substitute checks because substitute checks are a new type of payment instrument.

These special consumer protections for substitute checks were added out of an abundance of caution. There was no evidence put forward during Congressional and regulatory consideration of the Check 21 Act of any significant problems in the banking industry today in resolving consumer complaints with existing checks and check imaging systems.

6. Why don't the special protections under the Check 21 Act for substitute checks apply to all paper checks and check images?

The primary purpose of the Check 21 Act is to make the check processing system more efficient by facilitating the electronic processing of checks. Facilitating greater check electronic processing will, in the long term, lower the cost of check collection, provide new products and services to consumers, lower check fraud, and strengthen the nation's payment system against disruptions (such as terrorism) that may affect transportation of physical checks.

There was no evidence presented during the congressional/regulatory consideration of the Check 21 Act that any additional protections are needed for paper checks, check images, or even substitute checks. Banks are one of the most highly regulated industries in America, and they have a solid track record of dealing with customers' inquiries and disputes regarding their check payments.

Congress and the Federal Reserve Board considered -- and rejected -- expansion of these Check 21 Act consumer protections to all checks and check images. Indeed, the Federal Reserve testified during the Congressional consideration of the Check 21 Act that, in the view of the Federal Reserve, "expedited recredit provisions are not necessary for successful implementation of the [Check 21] act."¹

7. Do consumers lose protections when they receive a check image or check copy, as opposed to a substitute check?

No. The same traditional consumer protections against unauthorized, fraudulent and erroneous check payments apply to an original check, check image, check copy, or a substitute check. (See above discussion). The general rule is that if a consumer did not authorize a check transaction, the consumer is not liable and gets the amount of the check recredited or refunded to their account.

¹ Statement of Roger W. Ferguson, Jr., Vice Chairman Board of Governors of the Federal Reserve System, Hearing on H.R. 1474, The Check Clearing for the 21st Century Act before the House Subcommittee on Financial Institutions and Consumer Credit of the Committee on Financial Services, US House of Representatives, April 8, 2003. (<http://financialservices.house.gov/media/pdf/040803rf.pdf>)

The Check 21 Act does not change the current check image process, or the legal protections for consumers that receive check images. Banks have been providing their customers with check images and check copies as a record of paid checks for decades. There is no evidence from these years of experience that banks do not handle and resolve check disputes in an appropriate and timely fashion.

8. Can a consumer use a check image statement or a copy of a paid/canceled check (other than a substitute check) as proof of payment?

Yes. For years, the IRS, merchants, utilities, and other receivers of check payments have accepted as proof of payment by a customer any of the following: (a) photocopy of an original paid/canceled check, (b) image statement showing paid/canceled check, and (c) line item information on monthly periodic statements that identifies a paid check to payee.

Most consumers today do not receive back their original cancelled checks, and have successfully been using check images, check copies and line item information to prove payment for years. These check image statements will continue unaffected by the Check 21 Act.

9. Can consumers who receive a check image or copy of a paid/canceled check from the bank, demand that the bank provide them with a substitute check?

No. A bank is not required to provide a consumer with a substitute check, even if the consumer asks for the substitute check. Moreover, the Check 21 Act does not require a bank to be able to create a substitute check for any purpose. Some banks may, at their option, provide a consumer with a substitute check as part of their checking account services.

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