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## **Electronic Banking: The Check Truncation Issue**

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# Electronic Banking: The Check Truncation Issue

## Summary

The clearing process for checks is more expensive than other methods of payment which are cleared electronically, such as credit cards and Internet banking. The main reason is that check clearing requires banks to physically present and return checks unless they obtain legal agreements to clear electronically. The Check Clearing for the 21<sup>st</sup> Century Act of 2003 (H.R. 1474) would eliminate the requirement to physically return the original checks to the paying bank. On April 3, 2003, the Senate held its first hearing on the Fed's Check Truncation Act (CTA) proposal that was sent to banking committees of both Houses in December 2001. On June 5, 2003, the House passed H.R. 1474 and referred it to the Senate Committee on Banking, Housing and Urban Affairs. On June 18, 2003, at a markup, the Senate Banking Committee approved its Check Truncation Act of 2003 (S. 1334) and on June 27, 2003, the full Senate passed S. 1334 and incorporated it in H.R. 1474.

Estimates of cost savings from moving to electronic check clearing vary widely because estimates of the cost of using a check and the number of checks written each year remain in dispute. Consequently, estimates of cost savings range from \$1.4 billion annually for truncation alone to \$68 billion for replacing checks with electronic payments. A significant part of the estimated savings comes from eliminating handling, sorting, and physically transporting checks to the paying bank.

In testimony at the hearing of Senate and House banking committees in the 108<sup>th</sup> Congress, the Fed's CTA in the Senate and H.R. 1474 in the House were supported by the Federal Reserve Board, which testified that it would like to remove some of the consumer protection provisions that were in its 2001 proposal because they were unnecessary. The Fed argued that the regulatory burden these provisions would place on banks would outweigh the consumer benefits. Still, the bill is supported by America's Community Bankers, the American Bankers Association, the Consumer Bankers Association, the Financial Services Roundtable, the Independent Community Bankers of America, and technology firms like National Cash Register Corporation.

The opposition to the CTA came from the Consumers Union, supported in its testimony by the Consumer Federation of America, the U.S. Public Interest Research Group, and the National Consumer Law Center. The Consumers Union argued that the Act would make it impossible for an estimated 45.8 million U.S. households who are currently getting their paper checks back to continue to do so. These consumers would be less protected from fraud under the Act than under the existing check clearing process when there are disputes about check payments. The Consumers Union's suggested changes in the proposed legislation would significantly increase consumer protection. At the same time, these changes would increase financial institutions' costs of voluntarily adopting check truncation. Other witnesses argued that those banks with decades of using truncated checks have not experienced many disputed check payments, and when they did they were quickly resolved.

This report will be updated as legislative and financial developments warrant.

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# Electronic Banking: The Check Truncation Issue

## Introduction

The United States banking system processes approximately 42.5 billion checks annually, but only a fraction of these checks is processed electronically by check truncation. Check truncation occurs when the check is stopped before it reaches the paying bank and the check clearing process is completed electronically. (The term bank is used to include commercial banks, savings institutions, and credit unions.) The Federal Reserve Board (the Fed) has proposed legislation that would authorize the creation of “substitute checks,” an electronically produced instrument, that would allow banks to truncate the original check clearing process and complete the process electronically with the substitute check. The customers would receive the substitute check, which would be the legal equivalent of the original check.

If all checks were replaced by electronic transactions, the exact cost savings would still be unknown, because estimates of the cost of using a check and the number of checks written each year remain in dispute. Consequently, estimates of cost savings range from \$1.4 billion annually for truncation alone to \$68 billion for replacing checks with electronic payments. A significant part of the savings comes from eliminating the handling, sorting, and physically transporting of checks to the paying bank. To clear checks electronically, banks must negotiate processing agreements that make it unnecessary to physically present the paper check. Since the benefits are not uniformly dispersed among the participants, banks have found it difficult to obtain these agreements, thus constraining the widespread adoption of electronic check clearing.

## Legislation

**In the 107<sup>th</sup> Congress**, in December 2001, the Federal Reserve Board drafted the Check Truncation Act (CTA) and sent it to both the House Financial Services Committee and the Senate Committee on Banking, Housing and Urban Affairs to be introduced in Congress. On October 2, 2002, the Check Truncation Act of 2002 (S. 3034) was introduced by Senators Tim Johnson and Thomas R. Carper. Prior to that time, on September 25, 2002, the Subcommittee on Financial Institutions and Consumer Credit of the House Financial Services Committee held a hearing on the Check Clearing for the 21<sup>st</sup> Century Act (H.R. 5414), introduced on September 19 by Representatives Mike Ferguson and Harold E. Ford Jr. The bills, H.R. 5414, and S. 3034 and the Fed’s proposed bill, are almost identical. They would eliminate the requirement to physically return the original checks to the paying bank and therefore make it easier for more banks to voluntarily adopt electronic check clearing instead of continuing to use the paper check clearing process. The main difference between

the Fed's proposal and H.R. 5414 was that the Fed's proposal had greater consumer protection against unauthorized debits.<sup>1</sup> After the hearing held on September 25, 2002, no further action was taken in the 107<sup>th</sup> Congress.

**In the 108<sup>th</sup> Congress**, on April 3, 2003, the Senate held its first hearing on the Fed's Check Truncation Act proposal that was received in December 2001. The Federal Reserve Board's Vice Chairman Roger W. Ferguson Jr testified that the board would like Congress to remove some consumer protection provisions that were in its 2001 bill. "Upon further reflection, the Board has now concluded that the significant compliance burdens imposed by these provisions on banks that receive [the electronically produced] substitute checks outweigh the small incremental benefits that the provisions would provide to the consumers."<sup>2</sup> The vice chairman did not provide a new bill, but instead pointed out that "Nonetheless, Congress may conclude that the expedited recredit provisions for consumers should be included in the legislation. In that case, . . . it should not go beyond the provisions proposed by the Board."<sup>3</sup>

On April 8, 2003, the Subcommittee on Financial Institutions and Consumer Credit of House Financial Services Committee held a hearing on H.R. 1474, the Check Clearing for the 21<sup>st</sup> Century Act of 2003. The bill was introduced by Representatives Melissa Hart and Harold E. Ford Jr. on March 27, 2003. Substantively, the bill was not changed between the two Congresses. Vice chairman Ferguson's statement to the Committee was essentially the same as was the one presented to the Senate Banking Committee. On May 21, 2003, the House Financial Services Committee in its consideration and markup session amended H.R. 1474 and ordered it to be reported by voice vote. The amendment is a clarification amendment made by Representative Artur Davis. It would allow a consumer to make a claim for an expedited credit without possessing the substitute check.

On June 27, 2003, the full Senate passed the Check Truncation Act of 2003 (S. 1334) and incorporated it in H.R. 1474. At a markup on June 18, 2003, the Senate Committee on Banking, Housing, and Urban Affairs approved S. 1334. Earlier, on June 5, 2003, the Senate Banking Committee received H.R. 1474, which was passed by the House of Representatives the same day and referred it to the Senate. The two bills are quite similar. The major differences between the bills are mainly in the area of consumer protection. The CTA is more generous in its consumer protection provisions. For example, the CTA gives consumers 40 days to file an expedited recredit claim, while H.R. 1474 would give only 30 days. In

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<sup>1</sup> See Nicole Duran, "Fed Makes Case for Check Truncation," *The American Banker*, Sept. 26, 2002, p. 1.

<sup>2</sup> U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, Federal Reserve Board Proposal on Check Truncation, hearing, 108<sup>th</sup> Cong., 1<sup>st</sup> Sess. Apr. 3, 2003, unpublished, Statement of Roger W. Ferguson Jr., Vice Chairman, Board of Governors of the Federal Reserve System, [[http://www.senate.gov/~banking/03\\_04hrg/040303/ferguson.pdf](http://www.senate.gov/~banking/03_04hrg/040303/ferguson.pdf)], p. 6, last visited Apr. 8, 2003

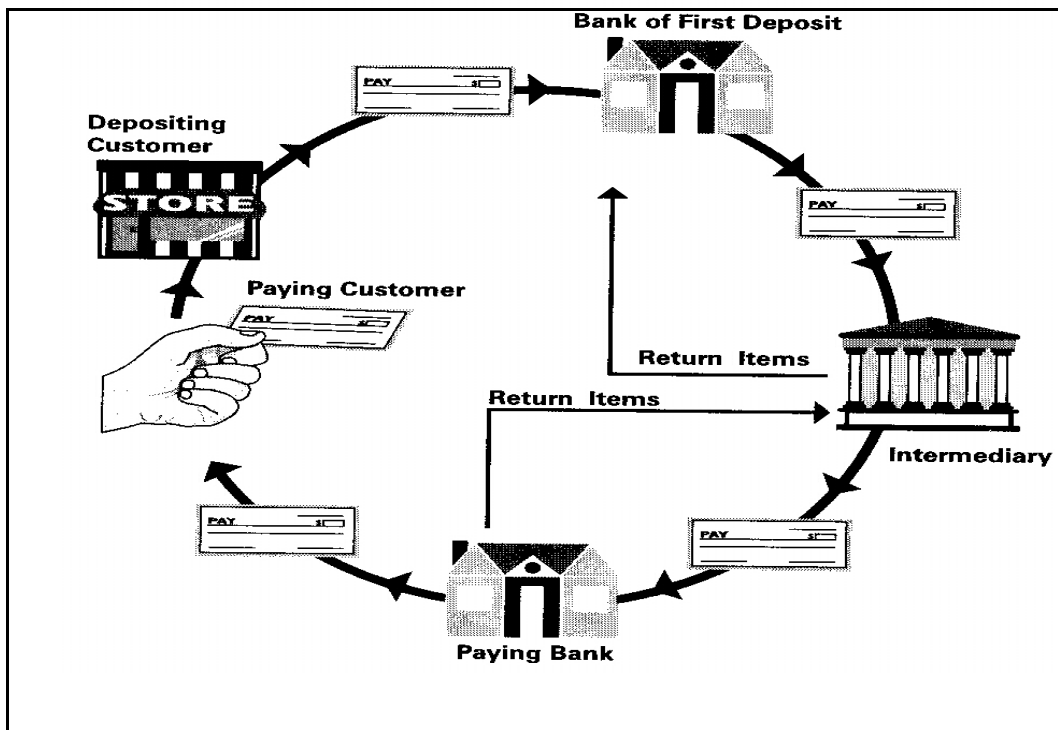
<sup>3</sup> Ibid. p. 8.

addition, the Senate's CTA would shift the burden of documentation more on the banks and less on consumers than the House's bill.

## The Paper Check Clearing Processes

**Figure 1** is a graphical representation of the existing paper check process. It begins with a customer paying a store using a check; then the store deposits the check in its bank, which may be different from the customer's bank. It is possible that the customer and the store have accounts in the same bank, in which case the check would be settled as an "on-us" item. In the processing of an on-us item, the bank of first deposit would simply debit the customer's account and credit the store's account in the amount of the check. It is estimated that 33% of the checks written in the United States are on-us items.<sup>4</sup> Assuming this check is not an on-us item, there are a number of ways that banks may clear and settle checks among themselves by the rules of interbank check settlement. The rules for interbank check settlement are

**Figure 1. The Paper Check Clearing Process**



governed by articles 3 and 4 of the Uniform Commercial Code (U.C.C.) and by Federal Reserve regulations J and CC.

**Source:** Federal Reserve Bank of Boston.

<sup>4</sup> Joanna Stavins, "A Comparison of Social Costs and Benefits of Paper Check Presentment and ECP with Truncation," *New England Economic Review*, July/Aug. 1997, p. 33.

After the store deposits the customer's check in its bank, the bank of first deposit can return the check to the paying bank by mailing the check directly to the paying bank, or by sending it through a third party intermediary (private clearinghouse,<sup>5</sup> a correspondent bank,<sup>6</sup> or the Federal Reserve System). Whichever of these methods the store's bank selects, in most cases, the check must be physically returned to the paying bank before it pays the check. This means that checks must be physically transported to the banks on which they were drawn before they are settled. Consequently, the paper check clearing process is subject to transportation delays.

If the customer does not have sufficient funds in the account to cover the payment to the store, the check is sorted out in the bank's backroom operations, and is returned directly to the depository bank or to the intermediary that returns it to the depository bank (**Figure 1**). Usually the depository bank returns the bounced check to the store, while charging a fee for depositing a check with insufficient funds in the account. The store then tries to collect from the customer. At the same time, the paying bank charges the check writer a fee for having insufficient funds in the account.

**Which Bank Pays for Collecting the Funds.** Under the Federal Reserve rules, a large portion of the costs of the clearing process, those related to collecting funds, falls on the depository bank — the bank in which the check was first deposited. The store's bank in the above example has to pay for any intermediary check clearing charges and for transporting the check to the paying bank. The legal requirement is that checks presented for payment must be paid at face value, even though the depository bank incurs cost in collecting the funds. It should be noted that the paying bank also incurs cost in paying the checks that are presented. However, if banks have an equal amount of collection and payment, these costs on net could tend to equalize among banks over time.

**Paper Check Clearing Is Inefficient.** Economists have argued that the continued use of checks has made the society worse off, because it wastes resources such as transporting checks by planes throughout the United States for collection. A check in the process of collection creates inefficiency, because it pays no interest (zero interest rate). As a result, the greater the difference between the market rate of interest and the implicit interest rate of zero, the greater the income that can be earned by using checks. This income is called the float. The float is income earned by the check writer between the time a check is given as payment and the time it is settled. The interest income earned from the float transfers income from the payee to the payer. Even though the net benefit of the float between the payer and the payee is zero (the payee's losses are the payer's gains), economists believe that the float is costly to society. Check users employ real resources to exploit the float for themselves. For example, the longer the plane takes to transport the check to the paying bank the greater the income the payer earns from the float. Of course, from the view of the check issuer, the float is not an inefficiency, but a benefit.

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<sup>5</sup> A check clearinghouse is an association of banks to facilitate daily exchange of checks. Checks drawn on one bank are offset against checks drawn on another.

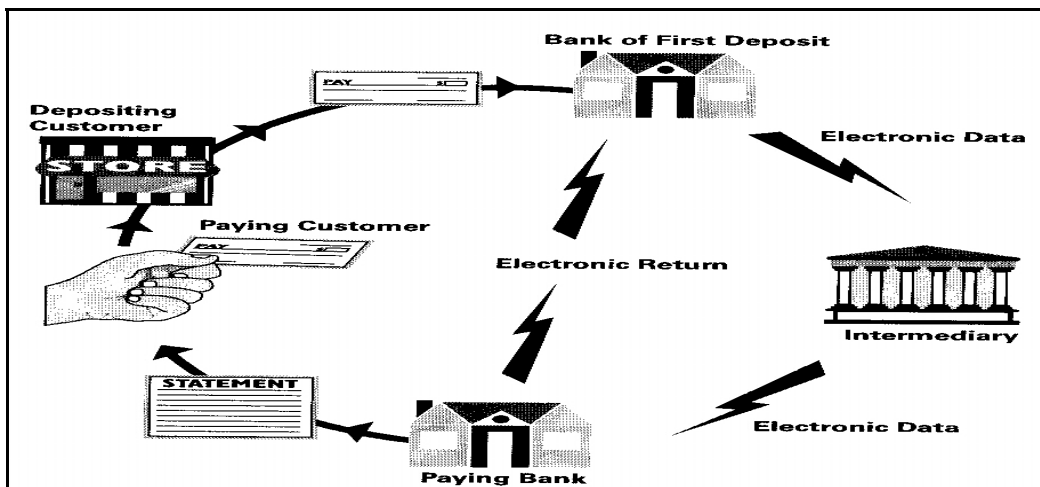
<sup>6</sup> Correspondent banks are banks having a direct connection or friendly relations with each other.

By one estimate (Wells), the cost to all parties involved in a check payment could average about \$1.60 (in 1993 dollars) more than the cost of a payment made electronically.<sup>7</sup> According to the Federal Reserve in 2001, government, households, and businesses wrote about 42.5 billion checks.<sup>8</sup> If the Wells estimate is correct, this might indicate a saving of \$68 billion if checks were replaced with electronic payments. A different study (Stavins) estimated a net benefit of \$1.4 billion from electronic check clearing.<sup>9</sup> It is generally accepted that there are potential savings to be obtained by adopting electronic check clearing.

## Electronic Check Presentation and Truncation

The electronic check clearing and settlement process is called electronic check presentation (ECP). Check truncation is a subset of the broader term ECP. Electronic check presentation is a check collection process whereby a check is cleared based on information contained in an electronic file or data, instead of the actual paper check. At a minimum, the file contains the amount of the check and the account number. The physical check may or may not follow the electronic file. When the check is truncated, it is stopped before reaching the paying bank (the check writer's bank, which is the bank holding the funds against which the check is drawn). Thus, under ECP with truncation, the writer of the check does not get his/her canceled check back. Instead, the transaction is indicated on the monthly statement (**Figure 2**). A check returned for insufficient funds would be returned to the depository bank electronically from the paying bank. The bank of first deposit would be able to return the bounced paper check to its depositing customer, or merchant, to support appropriate action against the paying customer.

**Figure 2. Check Truncation at the Bank of First Deposit**



<sup>7</sup> Kirsten E. Wells, "Are Checks Overused?" *Federal Reserve Bank of Minneapolis Quarterly Review*, Fall 1996, p. 2.

<sup>8</sup> See Revised Retail Payments Research Project at website <http://frbsservices.org/key-initiatives/retailpaymentsresearch.cfm>, last visited Apr. 9, 2003.

<sup>9</sup> Stavins, p. 37.

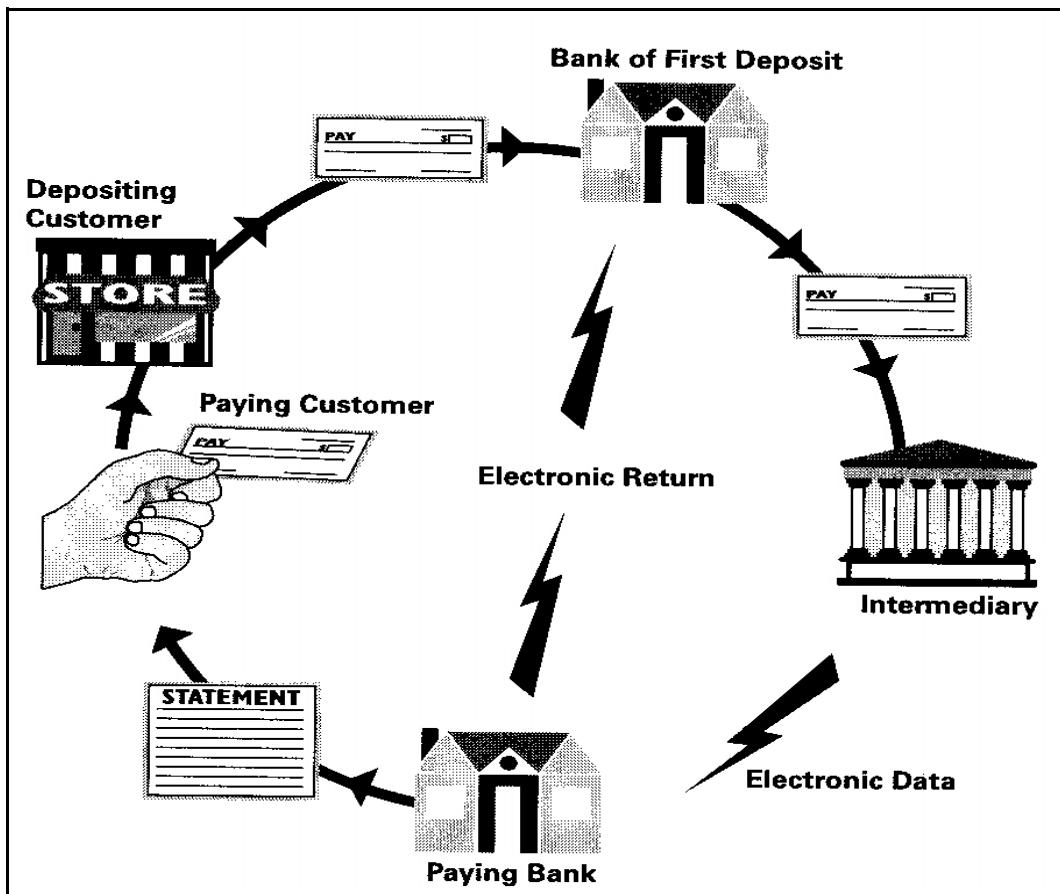


Source: The Federal Reserve of Boston

## Truncation by an Intermediary

If banks could not reach agreements among themselves on sharing the cost savings of electronic check clearing, they could use an intermediary to do the check truncations (**Figure 3**). The Federal Reserve currently truncates checks. In 2000, the Fed truncated 20% of the checks it processed. The use of an intermediary reduces the cost savings, since additional transportation, sorting and handling costs are involved when compared to truncation at the bank of first deposit. For these services, the intermediary charges fees that could be directly or indirectly passed through to the banks and their customers. Under truncation by an intermediary, the backroom operations of the first deposit bank would be basically unchanged, and the paying bank's clearing and settling activities would be reduced, but not eliminated. The Federal Reserve's suggested legislation would make it possible to use electronic check clearing without agreements.

Figure 3. Check Truncation by an Intermediary



Source: Federal Reserve of Boston

**Table 1. Estimated Per Check Payment Costs and Benefits of Check Truncation Over the Paper Check Process**

In cents (¢) and percent of costs (%) benefits (%)

### Costs

Depositing Customers	Paying Customers
Cost is Unchanged – 0.00¢(0%)	Loss of canceled checks and the float – 5.22¢ (78%)
First Depositing Bank	Paying Bank
Infrastructure (hardware, software, training, storage, research and additional operational costs) – 0.87¢ (15%)	Additional operating costs – 0.30¢ (3.5%)
Intermediary	
One time development, data processing and transmission costs	0.30¢ (3.5%)
<b>Total Costs</b>	<b>6.69¢</b>

### Benefits

Depositing Customers	Paying Customers
No loss of the float – 1.60¢ (14%)	No change in benefits – 0.00¢ (0%)
First Depository Bank	Paying Bank
Risk of fraud reduced, and lower transportation and operational costs – 1.04¢ (9%)	Lower cost on: sorting, handling, postage, return item processing, fraud identification – 7.12¢ (61%)
Intermediary	
Fewer readers/sorter passes, no loss of the float on rejects or weather emergencies, and cost saving on return items – 1.90¢ (16%)	
<b>Total Benefits</b>	<b>– 11.66¢</b>

**Source:** Figures taken from Stavins' Appendix B and percentages added.

Under ECP process, the estimated distribution of costs and benefits between the banks and their customers seems to be the reverse of what it is under the paper check process. Under the paper process for example, the paying customer gets the float and the canceled check, while under ECP, the paying customer loses the float and does not get the canceled check back. That makes it difficult for banks to adopt ECP without an explicit agreement about how they will share the benefits. On net, according to Stavins' study, represented in table 1, the paying bank's customers

would suffer the greatest cost from moving to the ECP process with the loss of canceled checks and the float. At the same time, the paying bank receives the greatest benefit. That benefit would be large enough to compensate its customers for their losses if it so chose and still leave it better off after adopting the check truncation process.

For the depositing bank customers, their costs are unchanged and they benefit from not losing the float. The depository bank's costs and benefits are estimated to be closer to break-even, but the net benefit is also positive. The higher infrastructure, storage, and operating costs are estimated to be slightly less than the benefit from reduced risk of fraud, and return check handling.

Despite the net benefit of check truncation, only a small number of banks have been using it. This could be explained by table 1. It estimates that total costs of 6.69¢ per transaction are exceeded by total benefits of 11.66¢. This clearly suggests that there are net benefits of 4.97¢ per payment in using check truncation instead of the paper check process. However, the distribution among participants in the check truncation process is not as simple. The paying bank's customers incur 78% of the costs and receive no benefit from changing from the paper check clearing process to check truncation. On the other hand, the depository bank's customers gain more than 14% of the benefit. For the banks, the paying bank receives 61% of the benefits, while the depository bank receives about 9% of the benefit. The intermediary benefits from the check truncation at the first bank of deposit since the truncation process would eliminate its handling of the paper checks. As a result, the intermediary accounts for 16% of the benefits.

There may be a concern that, to the extent that check truncation shortens the time for a check to clear, it may disadvantage those less wealthy individuals who live paycheck to paycheck and count on the float in paying rent and other bills. While such people would likely adjust to the new system, it may not be their preference. To the extent that truncation reduces the availability of the float, fewer checks may be written.

## **The Check Clearing for the 21<sup>st</sup> Century Act (H.R. 1474)**

The main difference between H.R. 1474 and the Fed's Check Truncation Act proposal is that H.R. 1474 has less consumer protection than the Fed's proposal. This legislation would facilitate wider voluntary use of truncated checks, without interfering with the check clearing process of institutions that do not currently have truncation agreements. The Act would enable this by creating a new type of paper document, a "substitute check," that would be the legal equivalent of the original check. The substitute check would:

- contain an image of the front and back of the original check;
- conform to the industry standards for substitute checks;
- contain the magnetic-ink character recognition (MICR) line that would permit the substitute check to be processed on check-sorting equipment; and,

- bear a legend that indicates that it is the legal equivalent of the original check.

Using this substitute check, a bank would be able to truncate a check from a bank with which it has no electronic exchange agreement by sending a substitute check instead of the original check. As a result, check truncation would remain voluntary. Banks that now use paper checks would be able to process either the substitute check or the original checks without any modification in their check clearing process or their back-office operations. The cost of check processing would be unchanged for banks already using check truncation and banks that chose not to adopt check truncation.

Much of the draft legislation spells out in detail the legal similarity between the original check and the substitute check under the uniform commercial code. For example, it would create a warranty structure to protect against losses associated with the substitute check. The proposal would also create an indemnity structure to address losses resulting from receiving a substitute check, rather than the original. In addition, the draft legislation would provide an expedited recredit procedure. Recredit is the act of giving credit to an account even though the documentation to do so is being questioned. In short, the recrediting procedure allows customers' accounts to be credited as soon as possible whether or not there are problems associated with the receipt of the substitute checks instead of the original.

The expedited recrediting sections of the Fed's proposal and the Check Clearing for the 21<sup>st</sup> Century Act are different. The Fed's proposal would give customers involved in a transaction where a substitute check was used a one day right to a recredit if they claim a check was improperly paid. That means that customer's account could be recredited the amount of the improper payment by the close of the next business day. In contrast, the Check Clearing for the 21<sup>st</sup> Century Act provides for a recredit 10 days after a claim of an improper payment. Under both versions, consumers using banks that have signed truncation agreements would not get this recrediting right. Only customers of banking institutions that have not voluntarily agreed to check truncation would have this right. Furthermore, under the Fed's proposal, the time the consumer has to request a recredit of disputed funds was 60 days. Under the Check Clearing Act, it would be 30 days.

## **Consumer Groups' Reaction to H.R. 1474**

At both the Senate Banking Committee and the House Financial Services Committee hearings on April 3, and 8, 2003, the strongest opposition to H.R. 1474 came from the Consumers Union. The views in its testimony were supported by the Consumer Federation of America, the U.S. Public Interest Research Group, and the National Consumer Law Center. The Consumers Union argued that the Act would make it impossible for an estimated 45.8 million U.S. households who are currently getting their paper checks back to continue to do so. It states that these consumers would be less protected from fraud under the Act than under the existing check clearing process when there are disputes about errors in the check payment process. Specifically, the Consumers Union argue that there is a loophole in Section 6 of the CTA that consumers could only see a recredit if they receive substitute checks from

their bank. Banks could avoid giving consumers the recredit just by refusing to return the substitute check to consumers.

At these hearings the Consumers Union made two recommendations to protect the consumers under the proposed Check Truncation Act.

- Because all consumers are equally susceptible to harm from processing errors, the recredit loophole in the proposed CTA should be closed. The right of recredit should be expanded to apply in every case where the original check is not returned to the consumer and a check may have been improperly charged to the consumer's account; and
- A comparative negligence standard is inappropriate to resolve harm suffered by consumers due to processing errors. Banks should not be able to use this standard to avoid liability, or to delay a consumer's action for improperly paid checks that result from processing errors. Therefore, as it relates to consumers, the language relating to comparative negligence standard should be removed from the CTA.<sup>10</sup>

At the hearing held in the 107<sup>th</sup> Congress on H.R. 5414, the Consumers Union suggests changes in the proposed legislation that would significantly increase consumer protection when checks are cleared electronically. These changes focus mainly on the recrediting procedure.<sup>11</sup> First, the Union would like to extend the recredit provisions in the Act to all checks where the original checks are not returned to the consumer and there is a claim of improper payment or a warranty claim. This amendment would expand the indemnification coverage beyond the substitute checks in the proposed H.R. 1474. It could extend coverage to more than 20% of all bank checks that are currently not returned to customers and more than 80% of credit unions' drafts that are also not returned to their members. Financial institutions are expected to oppose this extension because it would significantly raise financial institutions' cost of handling disputed checks and drafts.

Second, the Consumers Union argues that 10 days is too long for consumers to not have access to the disputed funds due to the use of the substitute check. It prefers the expedited recredit provisions in the Fed's proposal. That is by the close of business the next day, the disputed amount of the payment (up to \$2,500.00) would be credited to the consumer's account. The purpose of the provision is to reduce consumer inconvenience due to the use of the substitute check. However,

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<sup>10</sup> U.S. Congress, House Committee on Financial Services, Check Clearing for the 21st Century Act of 2003, hearing, 108<sup>th</sup> Cong., 1<sup>st</sup> Sess. Apr. 8, 2003, unpublished, Statement of Janell Mayo Duncan, Legislative and Regulatory Counsel, Consumers Union, also Supported by Consumer Federation of America, U.S. Public Interest Research Group and the National Consumer Law Center, [<http://financialservices.house.gov/hearings.asp?formmode=detail&hearing=204>], last visited Apr. 8, 20003

<sup>11</sup> See [<http://www.consumersunion.org/finance/checkwc102.htm>], last visited Aug. 24, 2002.

H.R. 1474 provides for a recredit after 10 business days, which the banking industry argues is appropriate.

Third, Consumers Union would like to raise the expedited recredit amount from \$2,500 to \$5,000. In H.R. 1474 and the Fed's proposal, checks for less than \$2,500 would be recredited by the next business day, if the check is being disputed. Consumers Union would like the expedited recredit limit raised to \$5,000 because the size of the amounts of these transactions is expected to increase over time. In addition, the Union would like to shorten the number of days required to complete the overall recrediting process to less than 20 days. Financial institutions, on the other hand, prefer the longer time to clear up disputed checks in order to make sure that corrections are made accurately. In short, the Consumers Union's changes would protect consumers from the loss of the fraud protection provided by the right to have the original check returned to them. This right is now protected by statute and regulations. These suggested changes, however, could significantly raise the cost to financial institutions to the point where it is no longer profitable to adopt check truncation.

A counter to the Consumers Union's argument for protection against processing errors is the fact that in cases where check truncations have been used for years processing errors are practically nonexistent and when they occur they are quickly resolved. Asked by Senate Banking Committee Chairman Richard Shelby (R-Ala.) how many complaints she has received from credit union members about electronically produced copies of checks, Alexander, President and Chief Executive Office of the NIH Federal Credit Union, said that over a period of 14 years, she had received none. In response to a question from Senator John Sununu (R-N.H.) Ferguson, Vice Chairman of the Federal Reserve System, said that in his seven years on the Fed board, he has never heard of a case in which checks were double-debited.<sup>12</sup>

## Possible Objections to Universal Check Truncation

Under the CTA, the adoption of check truncation or electronic check presentation would still be primarily voluntary, even though it could significantly reduce the cost of using checks. Many banks are not making agreements, because while there might be substantial social benefits if most or all checks were truncated, they and their customers may never be able to achieve sufficient benefits over the present paper check system to justify expending the resources to adopt check truncation. A major obstacle to universal adoption is the uneven distribution of costs and benefits among the participants in the process. Many observers believe this obstacle is unlikely to be overcome without a legally mandated cost distribution, as is currently provided for in the paper check process. The proposed Check Truncation Act would make legal any distribution agreement (or non-agreement) the banks approve among themselves.

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<sup>12</sup> Richard Cowden, Consumer Groups Prefer Paper Checks, BNA Daily Report For Executives No. 65. Friday April 4, 2003 Page A-15.  
[<http://pubs.bna.com/nwsstnd/ip/BNABAR.NSF/2002090b92a4a3bc85256743006da1ea/2f92eebadf7bc66985256cff000fca1b?OpenDocument>], last visited Apr. 9, 2003.

Under a voluntary process of adoption, whether or not a bank uses check truncation would depend on how well it fits with the bank's business strategy. Bankers faced with expensive technology adoption costs would not be likely to adopt check truncation if their customers place a high value on the float and on receiving their canceled checks. Large banks with millions of checking accounts would be more likely to support this legislation than smaller banks because they have greater potential of large scale savings, which smaller banks could never realize. However, even some of these large banks, which are heavily invested in other forms of payment, such as Internet banking, and credit and debit cards that have electronic clearing processes, may view check truncations as unwelcome competition. They may oppose initiating use of a substitute check, and if it becomes law, may refuse to adopt check truncation.