

Federal Reserve Bank of Atlanta

Check 21 Growth Shows No Sign of Slowing

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Moderator: *Considering the savings and efficiency that result from electronic check processing, Fred, why are some banks still processing checks the traditional, paper way?*



Herr: I think if we step back a few decades and remember that there have been a lot of false starts with electronification of checks. Predominantly the ECP [electronic check presentment] era that started in the '80s and carried through the '90s. Banks were told that paper checks were going away. However, they saw paper checks continue to grow. Now, with the legislation of Check 21 passing in 2004 [it took effect in 2004], this became a significant enabler for a depositor to electronify the check and enable the payer to either receive an electronic transmission or a traditional paper document known as a substitute check. I think with the enactment of this law, it truly enabled the industry. Now, the other thing that slowed the process initially was the fact that the banking industry as a paper processor is not standard enough to facilitate electronics. So what we are seeing right now is a reengineering of the deposit side and the backroom to enable institutions to go electronic to electronic. Some institutions were better positioned for this than others. What we have is basically a queuing process that is taking place inside the industry with the vendors and with processors. We've seen significant growth over the last quarter so we're looking for 2007 and 2008 to be pivotal years.

Moderator: *Is the rapid growth of Check 21 volume surprising at all?*

Herr: No, in reality we actually thought that the deposit volume would grow at about the rate that it is. The receipt volume has been a little disappointing. And that's basically because we didn't really think through the process enough and realize how much reengineering would have to take place.

Moderator: *Fred, the Fed has stated that Check 21 is designed to foster innovation in the payment system. Are we seeing that happen yet? If so how?*

Herr: Yes, it is happening and what it enables the institutions to do...always before, the receipt side was a barrier to electronification. Basically if a payer decided not to receive electronically a depositor could not do anything electronically. Now, the depositor can electronify the check then the payer has the option to receive a paper check and maintain their present flow of data or receive an electronic file. So it enables the sender to be able to move forward with the electronification process.

Moderator: *How far along are we toward seeing the real benefits of Check 21? Or, to put it another way, what benefits are yet to come and how significant will they be?*

Herr: I think we could categorize it as a first phase. We're presenting 25 percent of our items via Check 21 on the forward side. That will reach 50 percent by the end of 2007 or early 2008. And we feel that that's critical mass and that that will push the rest of the industry at a more rapid rate towards electronification. The industry is already seeing significant benefit. The large dollars have migrated into Check 21. On Martin Luther King Day, we processed \$43 billion. That's 50 percent of the dollars.

Moderator: *Check 21, as I understand it, is helping move the United States payment system closer to par with some more efficient payment systems in other countries, right? Why is that important?*

Herr: Here again, you have to step back, and because we've had such a robust, efficient paper system for so many years, the necessity wasn't there to reengineer and become more electronic. Other developing economies moved straight into electronic alternatives and chose these as alternative payment mechanism to paper. We also have a significantly larger banking base than most countries. In Canada, they have seven. So [in that country] it's a much easier process when you reengineer than what we have to go through.