

BITS

FINANCIAL SERVICES
R O U N D T A B L E

SAFEKEEPING AND ELECTRONIFICATION IN THE FINANCIAL SERVICES INDUSTRY

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TABLE OF CONTENTS

ABOUT BITS AND THE BITS PAYMENTS STRATEGIES INITIATIVE	3
INTRODUCTION	4
Background and Purpose	4
Definitions	4
AN HISTORICAL PERSPECTIVE	5
ECONOMIC IMPERATIVES.....	6
LEGAL ENVIRONMENT	7
TECHNICAL ENVIRONMENT	7
Industry Imperative.....	7
Technology Enablement – Imaging	8
Image Delivery	8
Electronic Check Presentment	9
INDUSTRY EXPERIENCE AND SUCCESSFUL STRATEGIES.....	11
Customer Acceptance	11
Savings Achieved.....	16
Barriers	17
CONCLUSION	18

ABOUT BITS AND THE BITS PAYMENTS STRATEGIES INITIATIVE

BITS, The Technology Group for The Financial Services Roundtable, is a non-profit consortium with membership reserved for the 100 largest integrated financial services organizations and qualifying affiliate organizations. Throughout its work, BITS seeks to sustain consumer confidence and trust by ensuring the security, privacy and integrity of financial transactions. BITS promotes the development of superior, market-driven technologies to strengthen the financial institution customer relationship, leverage resources and infrastructure across the industry, and maintain the industry's position at the heart of the payments system. BITS' Board of Directors is composed of the Chairmen and CEOs of twenty of the largest U.S. financial services holding companies as well as representatives of the American Bankers Association and the Independent Community Bankers of America. BITS' 2003 Priority Initiatives are focused in these areas: Crisis Management Coordination, Operational Risk Management, Fraud Reduction, Security and Risk Assessment, IT Service Providers, Privacy and Payments Strategies.

The BITS Payments Strategies Initiative focuses on a range of issues tied to legacy and emerging elements of the payments system, including developing analytical tools for use by member institutions, providing educational forums and assessing threats and opportunities. The Payments Strategies initiative is committed to identifying and evaluating the benefits and risks, both strategic and tactical, associated with changes and trends in the payments system. Participants examine the economic impact of the transition from paper-based to electronic payment mechanisms, including the information integrated within these payments mechanisms. The initiative also identifies ways to promote electronic check presentment (ECP) and check safekeeping.

The BITS Payments Strategies Steering Committee is chaired by **John Beran**, Comerica Incorporated.

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INTRODUCTION

Background and Purpose

Other than cash, checks are the most common method of payment for goods and services in the U.S. today. Continued advances in technology create opportunities for improvements in the check collection and settlement process. Banks and other financial services providers deploy new technologies to develop increasingly efficient means through which to collect and process checks for payment. The maker of the check sees the results of the collection process in a statement of account activity that may or may not include the return of the original check. When the original physical check is not returned, the term "check safekeeping" is used. The focus of this paper is to provide pertinent information about check safekeeping and check electrification to banks and other financial services providers that participate in the check collection and settlement process. The goal is to assist financial services providers in achieving efficiencies and improved customer service through check safekeeping and electrification.

Although this paper does not address electronic check conversion and other payment alternatives in detail, both subjects are discussed as they specifically relate to check safekeeping. These topics, and others relating to strategic payments alternatives, must be considered in depth when any firm seeks to develop an overall payment strategy. As this document took shape, for example, the BITS Check Safekeeping Working Group considered several fundamentally different perspectives on check safekeeping including one that suggested "leapfrogging" interim steps. In this view, bypassing the check safekeeping process was desirable in order to speed the rate of change of the payments migration process and to achieve a fundamentally more efficient end-state more rapidly. The authors encourage each financial institution to think broadly about payments strategies in the context of its own business plans as its senior executives consider whether and how to proceed with various check enhancement processes.

Definitions

Key terms are defined as follows for purposes of this discussion.

- **Check Safekeeping:** Check Safekeeping refers to the practice of non-return of physical checks in the account statements provided to demand deposit account (DDA) customers. The truncation of the paper items in this process has historically been accomplished by paying banks by agreement with their account holders.
- **Electronic Check Conversion:** Electronic Check Conversion refers to a process whereby a check is used as the source of transaction information, including check number, account number and financial institution identification number (R/T). This information is captured using MICR scanners at the point of sale or remittance processor and converted into a one-time electronic payment via ACH or an electronic debit network. The paper check is not a method of payment in this situation, is not retrievable by the paying bank and is covered by Regulation E as opposed to the Uniform Commercial Code.

- **Check Electronification:** Check Electronification is the practice of converting the Magnetic Ink Character data used to process a paper check to a file that is sent to a paying bank.
- **Electronic Check Presentment (ECP):** ECP refers to the practice of using check electronification to send a posting file to the paying bank for processing. This file is followed by the original check or an image of that check sent to the paying bank.
- **Check Truncation:** Check truncation is the process of eliminating the paper check with an accepted replacement that accurately represents the original transaction within the payment system.

AN HISTORICAL PERSPECTIVE

Check safekeeping has been practiced by financial institutions for many years. Credit unions have historically provided check safekeeping to the majority of their account holders who receive statements reflecting check activity. Credit unions first introduced the “share draft” in the mid 1970s, which, at the time, was payable through a commercial bank. This “payable through” designation combined with regulatory mandates provided the impetus for check safekeeping. As a result, 91 percent of all credit union share draft accounts currently use check safekeeping.

In testimony before the House Financial Services Subcommittee on Banking, Robert M. Fenner, General Counsel for the National Credit Union Administration, stated, “In the credit union context, truncation (check safekeeping as defined for purposes of this paper) usually 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 their credit union.”

Some other non-bank account providers only offer check safekeeping accounts, and the practice of not returning original payment documents has become the rule in the credit/debit card industry as well. So why is it that the banking business—with the greatest number of transactions each year (an estimated 42.5 billion in 2001 according to the Federal Reserve Study¹--has only 30 to 40 percent of its accounts nationally using check safekeeping? The answer has its roots in history, and in the conservative nature of the banking industry in general.

Checks are the oldest type of non-cash transaction mechanisms with the exception of barter. The check as a negotiable instrument has held a particular place in history that has created some of the inertia that exists within the industry today, especially in the commercial segment. Traditionally, a bank and its account holders have determined between themselves the issue of whether or not a check would be returned to a customer or truncated using check safekeeping. That is beginning to change. As of March 15, 2002, with simple notice,

¹ Bank’s Payments-Driven Revenues, Lawrence. J. Radecki, Federal Reserve Bank of N.Y.

merchants and lock-box providers can convert the information written on a check into electronic transactions that are covered by Regulation E. With this change, third party payees and customers can decide whether the paying bank will receive the original check to return to customers. In the first half of 2002, checks electronically converted under the NACHA rules totaled some 81 million items.

Returning or safekeeping original checks is also a regional phenomenon. Check truncation is more common in the western portion of the U.S. than in the east. This occurs in part because institutions located in the western U.S. have a less entrenched tradition of check returns and therefore less bias towards the practice. Marketing also plays a strong role and banks in the western U.S. have chosen to aggressively market check safekeeping to their customers.

ECONOMIC IMPERATIVES

Payments industry experts reported and projected declines in check-writing as early as 1994. In the fall of 2002, the Federal Reserve revised the November 2001 Depository Financial Institution Check Study estimates on the volume of checks written in the United States in 2000, lowering the number from 49 billion to 42.5 billion. This revision brings the check's share of the retail non-cash payments stream to 59.5 percent, down from 77.1 percent in 1995 and 85.7 percent in 1979.

Steve Ledford, President of Global Concepts (a consulting firm focusing on payments issues), estimates a two to three percent annual rate of reduction in the volume of checks written in the United States. Mr. Ledford also estimates that “the conversion of checks to electronic transactions could add an additional three percent to five percent to that reduction.” The economic impact of the declining volume of checks will be exacerbated by the expected over-capacity within the financial services industry’s check processing infrastructure. If check processing efficiency is not improved, the check could become one of the most expensive means by which to process payments. Increasing costs could further exacerbate the move away from checks and toward more cost-effective payment methods. Today, payments account for 30 to 50 percent of the non-interest income of most banks. Any shift in payment revenue streams, unless carefully managed, could have a significant impact on an institution’s financial performance.

In a recent report by McKinsey and Company on the impact of the decline in checks, the observation is made that, “In an unmanaged scenario, DDA profits are likely to come under significant pressure.” The report goes on to estimate, “DDA economics could decline up to 30 percent in the next five years.” One way to “manage” the DDA scenario is to speed up the clearing and settlement process by truncating (i.e., electronifying) checks as early possible in the collection process.

Check electronification also provides opportunities for new products and services that incorporate image technology. While the strategy for using image technology varies widely in the financial services industry, nearly universal agreement has been reached on the

economic case for truncation of the paper check followed by its replacement, if required, with a digital image.

LEGAL ENVIRONMENT

Rapid change marks the legal environment for safekeeping and electronification of checks. Checks are covered by the Uniform Commercial Code and also by the Expedited Funds Availability Act as implemented by the Federal Reserve's Regulation CC (Reg CC). In December 1999, Reg CC was modified to allow banks to agree to the exchange of image returns. The validity of image representations of original documents was confirmed in the Federal E-SIGN Act of July 2000 and in the various state enactments of the Uniform Electronic Transactions Act.

The relationship between an individual customer and the bank is also covered by a body of case law that has evolved over the last 300 years. Current law allows banks to truncate checks by agreement among themselves and between themselves and their customers. With thousands of chartered institutions, the probability of obtaining a significant percentage of these interbank clearing agreements is, however, remote. As a result, while the legal opportunity exists to expedite truncation and electronification of checks, until a bank has the ability to electronify all of the checks it processes; it must maintain dual processing streams. This need for redundancy currently prevents the check from achieving the operating efficiency necessary for it to compete with less costly payment alternatives. This competitive disadvantage provides part of the impetus for two bills introduced before the 107th United States Congress, HR5414 and S3034, both of which are based on the Check Truncation Act proposed by the Federal Reserve in December of 2001. These bills aim to provide banks with the ability to truncate checks without having to obtain discrete agreements from each party involved in the transaction. Banks would be allowed to use new technologies to manage the costs of check clearing without requiring that customers give up the practice of receiving a unique paper representation of their checks. Truncation also enhances the security of the check clearing system by reducing risks inherent in the physical delivery of paper checks.

TECHNICAL ENVIRONMENT

Industry Imperative

The financial services industry recognizes that it is imperative to re-engineer the traditional paper-based check processing infrastructure. Technology allows the industry to offer effective lower cost, alternative payment presentment and servicing methods, such as credit cards, debit cards, check conversion, stored value cards, electronic bill payment, telephone banking, Internet banking and others. Image technology is at the heart of the check processing change that is imperative for financial institutions. Check imaging technology enables the separation of the check's traditional paper medium from the legal and financial underpinnings of the payment process. Check safekeeping constitutes a parallel, fundamental imperative for change. Industry economics require that both processes gain wider acceptance.

Technology Enablement: Imaging

The value and potential associated with check image technology is extremely significant. With checks still dominating the non-cash payments transaction stream, processing with image technology will complement the electrification efforts of financial institutions. Check imaging can substantially reduce or eliminate time and costs associated with physical transportation of checks. Technology now exists for checks to be truncated at the point of presentment (e.g., retail branch, ATM, merchant) without further handling of the paper. As financial transactions grow in volume, and as geographic and customer servicing complexities increase, check processors must drive towards the cost savings afforded by innovative imaging and workflow synergies.

According to an article by Karen Epper Hoffman in BAI's *Banking Strategies* magazine (September/October 2002):

"...But even though imaging technology has been around for more than a decade, it mostly attracted community banks. The cost of processing and storing images made the technology unworkable for all but these small-scale community bank operations. The cost of storage was as much as 10 to 20 times more expensive just four years ago than it is today. And the capture equipment itself lacked the sophistication required by big-league processors. For that reason, larger banks tended to utilize imaging on a piecemeal basis, particularly for commercial cash management services such as lock-box reporting, proof of deposit, or occasionally, imaged statements. The quality of imaging systems also began to improve, as the cost for a megabyte of storage dropped from about 70 cents in 1998 to as little as two or three cents today, according to Bob Hunt, senior analyst for the Needham, Mass.-based Tower Group Inc."

Financial institutions acknowledge the additional efficiencies in customer servicing, reduced paper handling, shortened check collection cycles, and the potential for deferring or eliminating costly hardware acquisitions. As more banks and the Federal Reserve pursue check imaging and archive or document storage solutions, there is a potential to pool individual bank-owned archives into regional or national electronic check exchanges. Viewpointe Archive Services, a joint venture of Bank of America, JP Morgan Chase Bank and IBM, and the Endpoint network solution are examples of such exchanges. The movement toward bank-owned regional or national electronic check exchanges, similar to the rapid rise of ATM networks in the eighties, may help supplant paper-based exchange of checks by easing the transition to image exchange between banks.

Image Delivery

The first of several steps designed to introduce customers to image technology began with image statements and CD-ROM products. Advances in storage technologies continue to allow financial institutions to maintain high-volume image archives and provide images by bulk transfer on such media as CD-ROM. Manipulation and delivery of check images revolutionizes internal processing and customer servicing capabilities. Coupling the associated images with their electronic transaction information has brought the truncation of checks at the point of presentment to the forefront of the industry. According to Ms. Hoffman in *Banking Strategies*: "Imaging systems are becoming more cost effective for

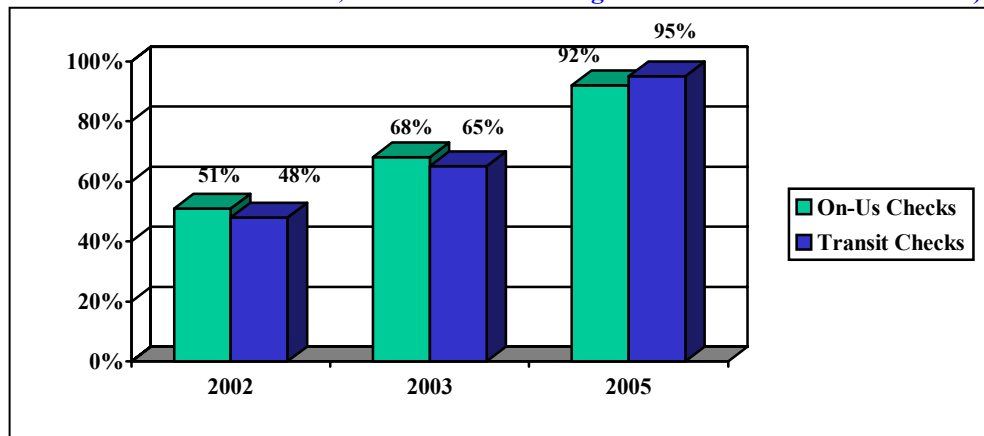
institutions that process large volumes of checks. And imaging proponents see other benefits. By capturing and storing checks as digital files that can be easily accessed, banks hope to improve customer service, create new revenue streams, reduce fraud and further persuade U.S. consumers to embrace automated payment vehicles.”

In effect, customers are better able to service themselves, and financial institutions can continue to keep operating and technology costs in line with shrinking check volume. Customer demand and image delivery are fueled by image archives with Web based delivery channels, enabling migration of more customers to check safekeeping.

Digital check imaging coupled with Internet delivery is becoming an attractive option, and banks are realizing that imaging applications can reach beyond back office processing efficiencies. The Internet facilitates image transmission and leverages browser-based delivery, eliminating the need for proprietary image viewers. A myriad of development tools and Web-based services can be used for delivering check images to the customer and to the bank branches and ATMs they frequent. This technology provides banks with the ability to move more customers into the safekeeping environment.

Image Archive Adoption

Expected Use of Image Archive for On-Ups and Transit Items
(Percentage of Total Volumes of each type;
assumes identical, constant rate of change for On-us and Transit volumes)



Global Concepts 2002

Banks are now looking at image technology enterprise-wide by considering document storage solutions that dovetail with workflow technology.

Electronic Check Presentment

The industry considers another technology enabler, Electronic Check Presentment, or ECP, an evolutionary stage in gaining increased traction in truncation. Although ECP has grown in acceptance over the last five years, it is not yet common practice. Of the checks presented by the Federal Reserve last year, 25 percent were “electronified,” and ECP still accounts for less than 20 percent of the inclearing checks traded by the 20 or so banks participating in these exchanges. In September 2002, there were only 75,819,028 items electronically presented through Electronic Clearing Services LLC. Economics, the legal and regulatory environment, and strides in technology are quickly making check electrification feasible

and an attractive alternative to traditional check processing for a growing number of institutions.

ECP provides value by allowing banks to accelerate the posting of check transactions a day earlier. It is a mature technology enabler that assists banks in the migration to an image-based truncation environment. Once the migration toward full truncation begins, safekeeping of checks is expected to gain rapid acceptance by customers of financial institutions.

In 1996 the Electronic Check Clearinghouse Organization (ECCHO) formed a task force to develop a strategic vision for ECCHO and ECP. The ECCHO vision identified a short-term industry value of two to three billion dollars per year in savings and revenue. The ECCHO study accelerated the need for a revised approach to ECP and image technology. Now, ECP, image archive, image exchange, and truncation of paper checks occupy a place on almost every cooperative industry group's agenda.

Several large financial institutions have implemented ECP to improve the check collection process and to reduce the time required for identifying check returns. However, ECP has not achieved its widely anticipated potential due to operational issues such as requirements to match electronic (MICR) files to the paper checks that follow, and software and procedural modifications. Other industry priorities such as mergers and consolidations, increased penetration of non-check payment streams, and implementation of imaging and workflow capabilities also contributed to the slower than expected rate of ECP adoption.

In the late 1990s the financial services industry forged further collaborative efforts, forming the Small Value Payments Company (SVPCo) network to foster the growth of check electrification initiatives among the nation's largest institutions. ECP exchanges like SVPCo, while not initially focused on the elimination of transporting checks, have accelerated check processing cycle times by capturing and transmitting MICR information electronically. SVPCo is also focused on the evolution of ECP coupled with image delivery through its network.

In 1998 the BITS Board of Directors (including the CEOs of the country's largest financial institutions) established ambitious ECP goals for the industry:

- By 2001, 100% of the country's largest banks should process 50% of their check volume through ECP.
- By 2001, 50% of the country's medium size banks should be processing some portion of their check volume through ECP.

The BITS Board of Directors reviews industry progress toward those goals regularly, and while progress at larger financial institutions has been good, adoption at medium size banks has been slower than expected. As a result of those trends, BITS, in cooperation with other interested industry organizations such as American Bankers Association (ABA), America's Community Bankers (ACB), ECCHO, and Independent Community Bankers of America (ICBA), has begun a series of ECP Forums targeting banks in certain markets where coordinated actions and emerging technology can combine to create a compelling economic case for check electrification

INDUSTRY EXPERIENCE AND SUCCESSFUL STRATEGIES

Customer Acceptance

Given the compelling case for adoption of a truncation strategy by financial institutions, which can only be enhanced with the widespread introduction of image repositories, what changes have taken place in customer acceptance and what impact have these changes had on institutions' operating P&Ls? We will attempt to answer these questions using several different data sources and time periods.

First, we will revisit the *BITS Industry Overview of Check Safekeeping Practices* published in November of 2000 and summarize those findings. In June 2000, BITS surveyed financial institutions in the U.S. to identify successful strategies to achieve check safekeeping, and to quantify the operational impact of check safekeeping programs. Check safekeeping was defined to include any checking account statements that do not include the return of original customer checks (truncation, image statements). A total of 55 financial institutions responded to the survey, including 29 BITS member financial institutions and 26 members of the Independent Community Bankers of America (ICBA).

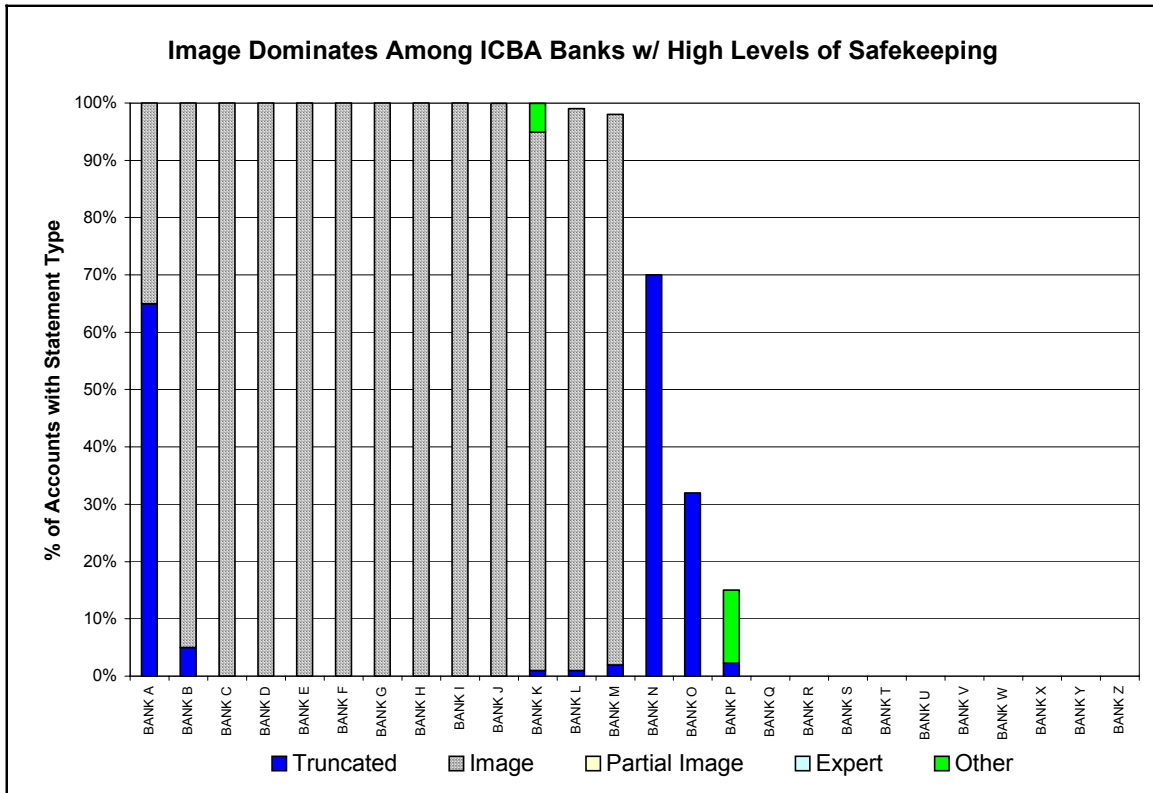
Overall, the median check safekeeping rates reported by survey respondents were 44 percent of accounts for BITS banks and 32 percent of accounts for ICBA banks. This figure is somewhat misleading, however, because of the wide range of safekeeping rates reported—from 0 percent to 100 percent. It is important to note that the ICBA respondents were more likely to be at the extremes, either reporting all safekeeping or none. In contrast, the BITS institutions reported a more typical distribution of safekeeping rates, with the majority safekeeping one-third to two-thirds of consumer accounts. This performance differential is attributable to the fact that ICBA community banks were much more likely to mandate safekeeping for all customers than the larger BITS institutions.

The 16 banks that achieve the highest rates of check safekeeping (greater than 90 percent) have made image statements or truncation the standard offering for all accounts, or have simply mandated that all accounts will be converted to safekeeping. Most of these banks combine two highly effective programs: a negative response campaign for existing accounts and a default statement offering of safekeeping for new accounts. Six of the banks have taken the more aggressive step of simply converting all accounts to check safekeeping without offering the option of check return. All but three of this group of 16 institutions relied heavily on image statements as the default form of truncation.

The smaller ICBA banks that have implemented a safekeeping strategy generally position image statements as the solution for all consumer accounts. Of the 13 ICBA banks that have moved over 90 percent of their accounts to safekeeping, all but one has moved over 95 percent of its customers to image statements.

The larger BITS banks are more likely to adopt a strategy that offers customers the option of truncation, image statements or check return. Truncation is generally offered to low-end customer accounts, while image statements are provided to mid-level and high-end accounts. The three BITS banks (Banks A-C) with the highest safekeeping rates (greater than 90

percent) have moved at least three-quarters of their safekeeping accounts to image statements.



One bank stands out in contrast to the other banks that have employed the “default safekeeping” strategy. This bank was able to achieve a safekeeping rate of 72 percent through targeted marketing of account products tailored to specific market niches, each of which had its own default statement option. This approach was supported by strong pricing incentives; in essence leading existing and new customers to choose the account package best suited to their needs. This approach achieved much higher rates of truncation than achieved by those institutions relying solely on negative response and image statements.

Some large and small banks have been able to achieve moderate and even very high levels of check safekeeping without offering image statements. Two of the ICBA banks and four of the BITS banks were able to attain moderate to very high rates of safekeeping without offering an image statement option.

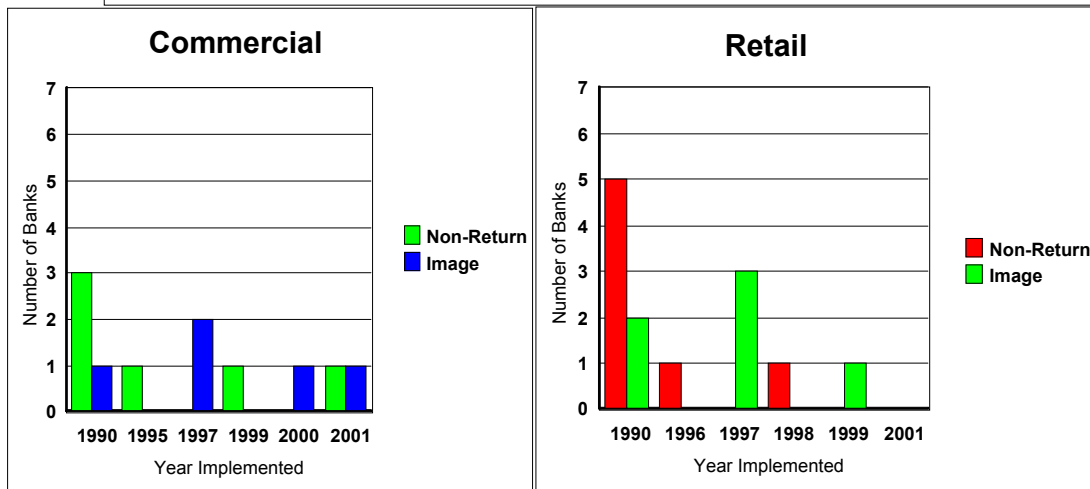
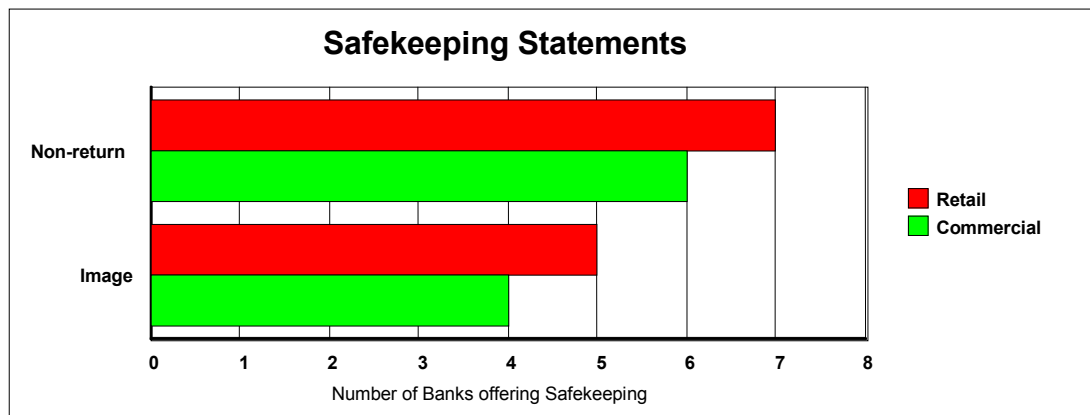
Although even check safekeeping rates of 10 to 30 percent can achieve significant cost savings, this paper focuses on techniques that can enable much higher penetration. It is therefore instructive to compare the practices of financial institutions with high rates of safekeeping (70 percent or higher) to those achieving more modest rates. Financial institutions reporting 10 to 30 percent rates of safekeeping:

- Were more likely to rely on attrition to convert the existing account base to safekeeping;
- Did not employ negative response campaigns or mandate safekeeping; and

- Were more likely to rely on pricing incentives as the sole means of promoting check safekeeping.

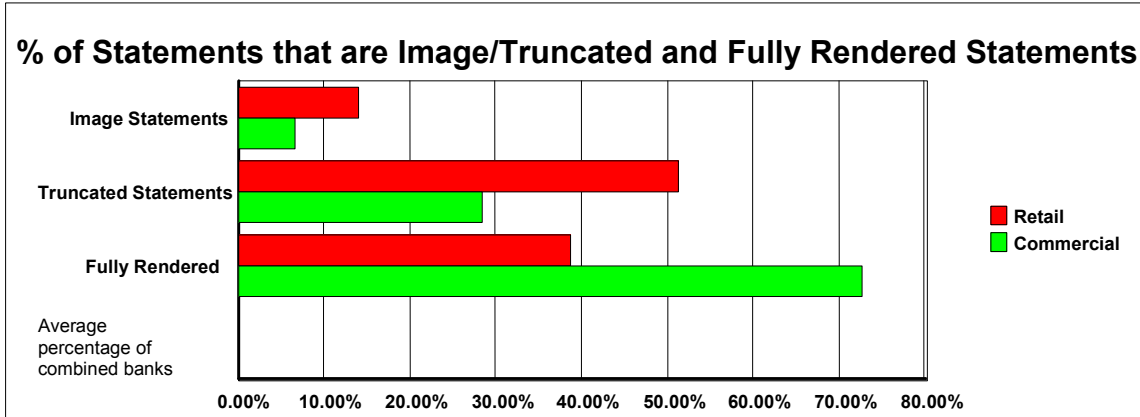
Overall, industry experience to date suggests that a check safekeeping program relying on passive techniques such as attrition or pricing differentials alone will achieve only modest results. Check safekeeping must be supported by active promotion, including either a negative response/mandate campaign or creative product positioning. A complete copy of the survey results is included on the BITS Web site at www.bitsinfo.org.

The second survey we will cite, conducted in 2002 by Comerica, included seven peer institutions of mid- to large-bank size. All of the banks have check safekeeping programs, several since the early 1990s. All but one has subsequently implemented an image archive and statement strategy.

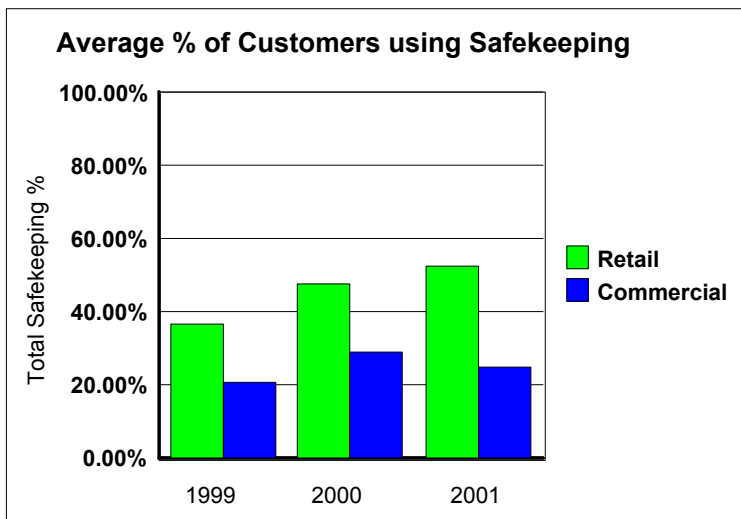


Averaged over the institutions surveyed, retail statement truncation exceeds fully rendered and image statements while commercial accounts continued to be dominated by check returns. The ranges included in the averages shown below are:

- Truncated-Retail 15-82%
- Commercial 0-72%
- Imaged – Retail 0-23%
- Commercial 0-11%



Growth in the use of check safekeeping in the past three years has been on average steady for the retail segment and somewhat flat for the commercial segment. (A statistical anomaly exists in the commercial data for 2001. The actual results are equal to 2000.)



A further update from the Global Concepts Payment Study 2002 concludes that of the 57 institutions surveyed, 46 percent employed truncation, 13 percent truncation with imaged statements and 41 percent check return with statements. Global Concepts speculates that the trend will continue toward truncation for the consumer mass market, with imaged statements to upscale customers and commercial accounts. No breakdown between commercial and retail accounts was provided.

The Comerica survey also sought to validate the type of incentives used to support the programs and move customers toward safekeeping. The results concluded that the vast majority of the respondents used a three-tiered approach; charging for the return of checks at the highest level, image statements as a second tier, with check safekeeping as a third.

One of the participating banks had conducted a very aggressive test market program in several market regions during the latter part of 2000. This approach established a three-tiered pricing model: the highest cost for check return, a lower cost for imaged statements for retail accounts and no fee for safekeeping accounts. The program included notification to existing customers that they would no longer be receiving checks beyond a certain date, but had the option to pay for images of returned checks. Furthermore, all new account openings would default to check safekeeping. The program was supported by an executive sponsored internal marketing and training campaign. The results were compelling. Attrition was less than normal; 91 percent of the clients remained in check safekeeping, 4 percent chose image statements and 5 percent chose check return. New account rates were relatively nominal with 84 percent safekeeping, 7 percent image and 9 percent check return results. Negative customer reaction was minimal.

Further reinforcement for the value of safekeeping and image enablement can be found in BAI's *Banking Strategies* article, "Image, Coming of Age." In the article, Karen Epper Hoffman reports, "that several large banks (with safekeeping programs) have revisited earlier image projects previously tabled due to Y2K and Internet investment priorities."

She reported that improving economics have emboldened several large banks to revive earlier projects. These include Comerica Inc., Wachovia Corp., and Huntington Bancshares. Comerica has been building its archive of business and retail imaged checks since 1997 at its Livonia, Michigan operations center, but only recently began rolling out imaged (or truncated) statements in its Michigan and Texas markets. About two-thirds of its Michigan customers now receive a statement that does not include the return of paper checks (the bank charges a premium for returned checks). At Comerica's Web site, Internet banking customers can look at checks that have posted against their account through the previous night. Both retail and commercial customers can access their check images weekly or monthly on CD-ROM.

In the summer of 2002, Comerica began upgrading its image-capture capabilities from a courtesy amount recognition system, which automates almost half the sorting, to a more sophisticated system that includes legal amount recognition. The project will, "eliminate the need for human intervention in 70 percent of the items," according to Paul Obermeyer, Senior Vice President of Operations, Comerica Bank.

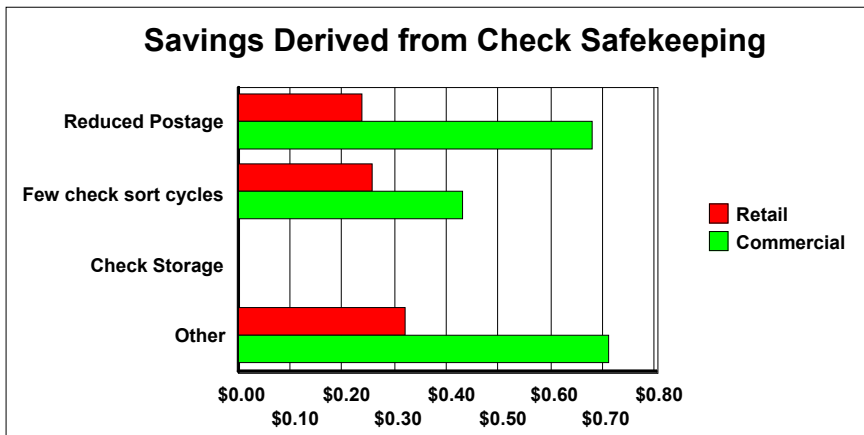
Huntington began archiving its check volume in 1992 and had a fully digitized central archive by 1999. In that year, it also began rolling out imaged and truncated statements. Dan Vermeire, Vice President and Chief Technology Officer, Huntington Bancshares, estimates that 60 percent of the bank's customers currently receive a truncated statement, which does not include either the paper checks or imaged replicas. In March 2002, Huntington's online banking customers gained the ability to view copies of their imaged checks via the Internet going back 60 days. Call centers are already hooked into the bank's image archive, and Vermeire reports that as of September 2002, all 300 Huntington branches had the ability to capture and clear check.

Wachovia, still in the throes of merger integration after its September 2001 marriage with First Union Corp., has been introducing imaging services in stages. Legacy Wachovia customers could view imaged checks online as early as December 2000, while legacy First

Union customers received that service earlier in 2002. The combined bank's 1.5 million online customers are now viewing nearly two million images a month, which cuts down the volume of inquiries to the call centers, says Ron Kerr, Senior Vice President and Internet Director for Retail Products. Old Wachovia branches and call centers, which are equipped with PCs, can retrieve images directly from the archive already; that service should be established at the former First Union branches by the time integration is completed in mid-2003.

Savings Achieved

The savings to be achieved with check safekeeping and image-enabled programs have been well documented. In a study conducted by Global Concepts for one regional bank, the savings in postage and internal processing costs, when compared to traditional check return, were estimated to be \$.343/account/month when truncated and \$.14/month/account if an imaged statement is provided. The Comerica study conducted earlier this year shows even larger savings accrued to the participating banks—a range of \$.36 to \$1.02/month/account with a median average of \$.49.



Other savings associated with image-enabled platforms include improved efficiency, effectiveness, and customer service. Elimination of microfilm operations, speed and accuracy of research, and improvement in statement production time are also often cited. Customer satisfaction is seen in the timely resolution of inquiries in the branch, customer service centers or directly through the Internet Banking Platform. Robert Hunt, senior analyst at Tower Group Inc., believes that the cost efficiencies of online images alone are impressive. For example, providing a copy of a check from microfilm can cost the bank up to \$7 and take three to five days, whereas online [image] access virtually eliminates both the cost and time.

Karen Epper Hoffman reports that when it comes to cost savings, imaging might actually provide its greatest benefit by reducing check fraud, which costs the banking industry an estimated \$12 billion to \$16 billion a year. A spokesman for Bank of America Corp. says imaging technology enables the bank's tellers and fraud detection analysts to quickly detect bogus or forged checks by comparing them with legitimate signatures kept on file. The system also spots inconsistencies in check numbers, and the reduction in float time narrows the time window for fraud.

A substantial body of work, *The Evolution of Fraud Prevention Technologies in a Truncation Environment*, has been recently published under the auspices of the BITS Fraud Reduction Steering Committee and is available through BITS and on the BITS Web site at www.bitsinfo.org under Publications

Barriers

Easing the way for check safekeeping requires strategies for overcoming barriers that are typically related to customer acceptance, regulatory, technical and economic issues. .

Consumer resistance exists due to concerns related to the legal standing of the original check versus a copy of the check as a receipt or evidence of the transaction. This concern is often related to IRS matters. Resistance is also created when the receipt of the original check is imbedded in balancing and record keeping routines of consumers or businesses. Financial institutions have not always succeeded in convincing all their customers to change their routines.

Regulatory barriers are more in the omission of current capabilities than in the prohibitions created by them. Most regulations were created before the current strides in technology and other enabling factors for check safekeeping and do not contemplate the current state of affairs. Two notable exceptions are the E-SIGN Act and the proposed Check Truncation Act. Other regulatory updates will overcome the barriers of omission, but will be slower than the industry would like. Efforts to change the Uniform Commercial Code exemplify the slow process of regulatory change.

Technology has generally not been a barrier to check truncation. Limited success has been demonstrated using traditional microfilm based check processing methods tied to the non-return of checks. Other opportunities increased when the image statement was introduced in the early 1980s. It has only been recently, however, that the technology, price performance and Internet delivery channels have converged enabling a compelling case for some institutions to replace traditional microfilm-based infrastructure. Obstacles still exist for other institutions that have yet to rationalize a viable business case based on their particular investments and customers. It is our view that the industry should continue to support these and other initiatives which will move us toward the most cost effective and customer-centric payments environment.

CONCLUSION

Significant opportunities exist for financial institutions to reduce costly handling and movement of checks and to create innovative and cost effective products and services based on image-enabled workflows. The evolution toward truncation and safekeeping of checks is a business imperative and will be reinforced by the acceptance of check electronification and non-check payment methods.

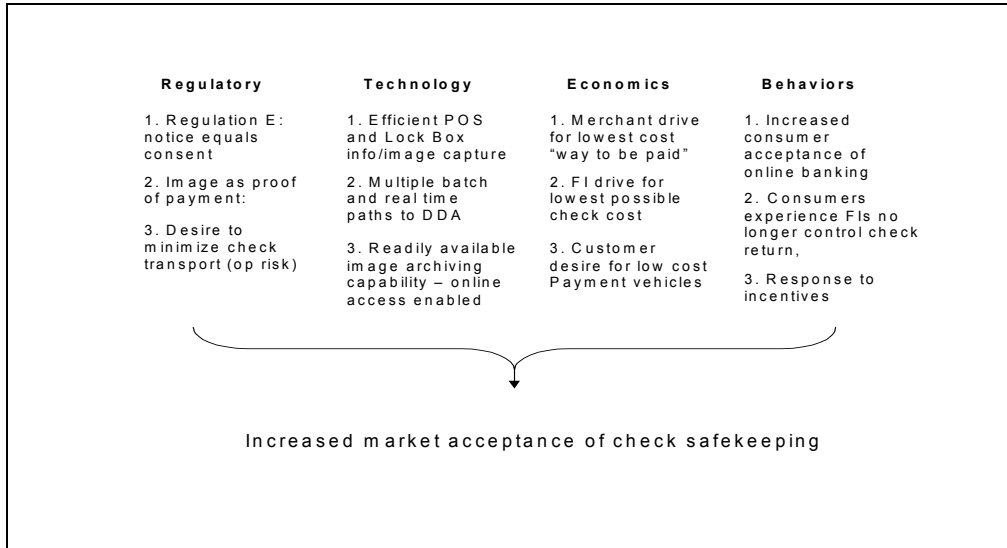
Collaboration and cooperative exchange, guided by a legal framework that we believe will be enhanced by the proposed check truncation legislation, are evolving. Financial institutions are fundamentally changing their check-processing infrastructure to be image enabled. Industry groups are currently developing standards and pilots related to image exchange, all directed toward capitalizing on the efficiencies and customer service enhancements made possible through non-paper processing.

While there is growing acceptance for check safekeeping among retail customers, commercial accounts are lagging behind. These accounts represent a substantial part of the check volume. The challenge is to develop educational programs targeted towards commercial customers and their advisors (these would include attorneys, accountants and regulatory bodies). As image archives and Internet access become more widespread, that educational outreach can point to significant customer service enhancements in addition to any economic incentives that might be part of a conversion program.

Internally, it is important that corporate cash managers and operations managers work together to insure a winning scenario for the bank when introducing check safekeeping, image products, and pricing strategies. Operational savings and fee income generated by this process must be optimized with incentives to gain customer acceptance. ECP and image promise long-term efficiencies for the check system. Realizing these efficiencies requires industry participants to work cooperatively to refine standards and processes.

The industry's best practices show that a majority of retail customers will accept safekeeping, especially in an image capable environment, and that additional, fundamental changes to the environment will accelerate the trend toward check safekeeping. At the same time, based on NACHA electronic payment initiatives introduced earlier this year, the frequency with which the customer will receive a check back will significantly decline and could modify customer behavior to an extent not seen in many years. In fact, the convergence of a range of behavioral, economic, technology, and regulatory factors will lead to increased check safekeeping adoption (see diagram, below). The time is right for the industry to take advantage of this opportunity by providing the kind of enhanced checking infrastructure and services that will make it easy for customers to say "yes" to check safekeeping.

Convergence of Factors Affecting Check Safekeeping Adoption



As a recent Carreker report phrased it, "U.S. banks have a one-time opening here to accelerate, facilitate and lead this compression of payments, to move all aspects of payment transactions (presentment, capture, image, fraud mitigation, exceptions, and settlement) as close as possible to the point of presentment. It is an industry event and an imperative one."²

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² [Payments at a Crossroads: Four Certainties for U.S. Banks](http://www.carreker.com), A White Paper by Denny Carreker, 2002, p.6, www.carreker.com, 02/25/02