



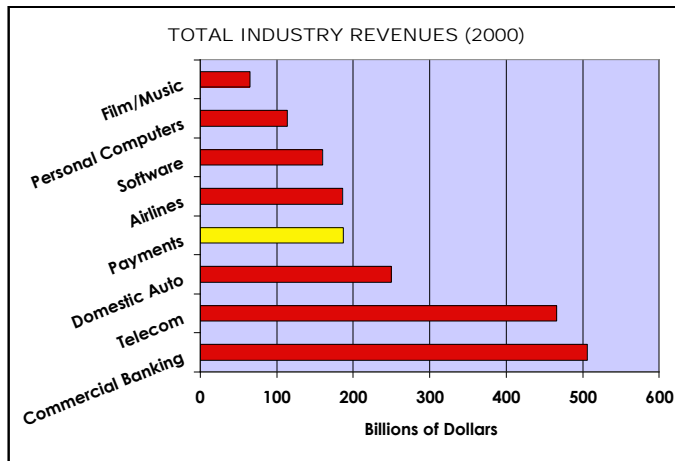
Check Truncation: Common Misconceptions A Top Ten List

TAWPI Great Lakes Chapter
Chicago, IL
February 13, 2003

R. J. Poje and Company
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Treasury and Payment Solutions to Grow...Not just Survive

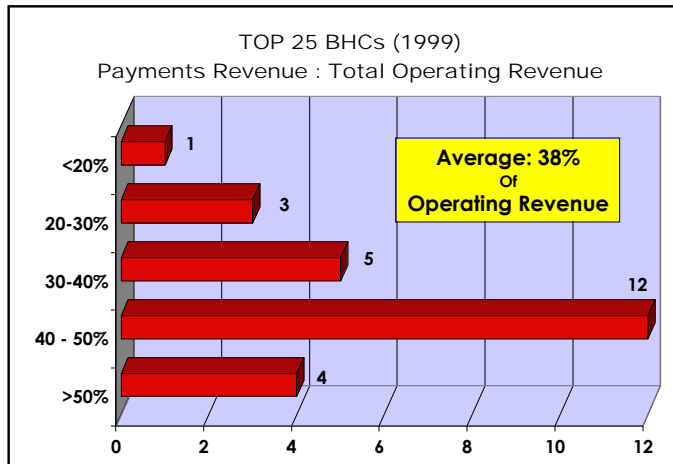
Payments are "Big" Business



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Top Ten List

Truncation Misconceptions

- 1) Truncation comes in one flavor only
- 2) ARC, RCK, TEL, and CTA spell the beginning of the end for checks
- 3) All checks can be truncated
- 4) Companies have to create check image archives to implement ARC
- 5) Check writers have and will reject truncation
- 6) Truncation broadens corporate access to the Fed
- 7) Only ARC items are eligible for RCK return processing
- 8) Truncation is a future event
- 9) Truncation will reduce lockbox operating costs
- 10) Implementing truncation is a no-brainer

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Top Ten List



Truncation Comes in One Flavor Only



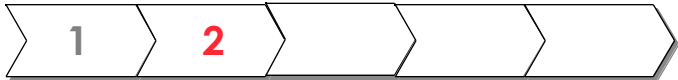
More Flavors Than Baskin-Robbins

Media	Paper, Paper to ACH, Paper to Other Electronic, Electronic to Paper
Body of Law	UCC (State), EFTA, Regulation E (Fed) And Contract Law
Transaction Origin	B2B, B2C, C2B Check Processing, POS Return Item Processing System
Processing Channel	ACH, Bilateral Agreements, Conventional Check Processing System, Other?
Cultural Perspective	Consumer Acceptance/Rejection FI/Trade Association Perspectives

More Flavors in the Future?

Media	Probably Covered
Body of Law	Stronger Anti-Fraud Legislation National Security/Anti-terrorism Issues
Transaction Origin	Totally Paperless Origination
Processing Channel	Card and ATM Networks? Intraday or Realtime Channels?
Cultural Perspective	Corporate Check Truncation Resolution of Consumer Issues

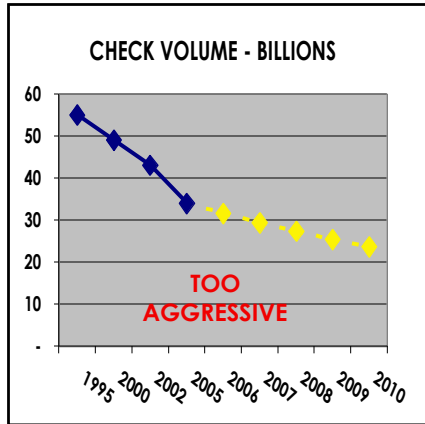
Top Ten List



**ARC, RCK, TEL, and CTA Spell the Beginning
Of the End for Checks**



Check Volume is Declining



Most Rapid Decline

- Government (G2B, B2G, G2C, C2G, G2G)
- Payroll
- Corporate A/P
- Consumer POS

Least Rapid Decline

- Consumer Bill Payment
- P2P

No Indication Checks Will Disappear

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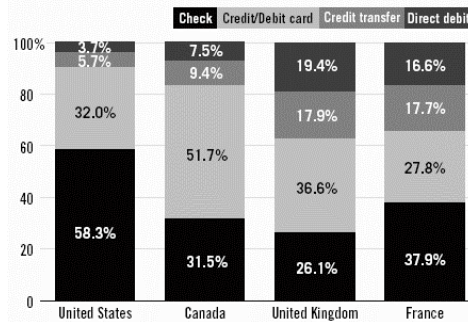
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Consumer Preferences @ POS

Data Snapshot

Cashless retail payments, from Celent Communications



American Banker 1/14/03

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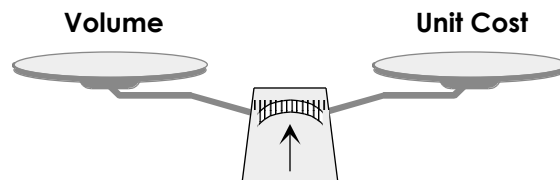
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Check Volume is Declining?

- ❑ **Consumers continue to prefer checks for bill payment**
 - “Unbanked” segment below 10% of all households, according to Federal Reserve (down from 14.5% in 1990)
 - Households continue adding about one bill payment app per year, with checks the preferred payment mechanism
- ❑ **American consumers value “choice” and “convenience”**
 - They are reluctant to surrender options, especially when making payments
 - Consumer payment preferences **hybridize**. They do not **evolve**, and old methods do not disappear

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Consequences of Hybridization

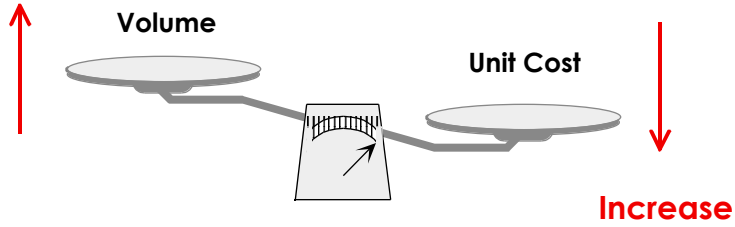


**Volume and Unit Costs Find
An Equilibrium Over Time**

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Consequences of Hybridization

Decrease



Hybridization Creates Disequilibrium

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Top Ten List



All Checks Can Be Truncated



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All Checks Not Truncatable

Paper Truncation	Application Defined - Limited Almost Exclusively to Consumer Items
ARC	Corporate, 3rd Party, Credit Card Checks Drafts, Treasury Checks, Non Dollar Items
RCK	For re-presentation of consumer checks <\$2,500 returned as NSF or unavailable
CTA	Treasury checks, under certain circumstances
Bilateral Agreements	Treasury checks

Top Ten List



Companies Will Have to Create Check Image Archives to Implement ARC And Other Forms of Truncation



Image Archive Requirement

- ❑ **A Convenience (Maybe) - No Longer A Requirement For Most Payment Processors**
- ❑ **Emergent Services For Archive Outsourcing:**
 - Endpoint (AFS)
 - Viewpointe (Chase/BofA)
 - Fed Archive Initiative
 - Other Ventures
- ❑ **Web Services and/or EAI for Archive Linkage and Integration - National, Apparently Seamless Archiving and Retrieval**

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Top Ten List



**Check Writers Have and
Will Reject Truncation**



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Opt-Out and Rejection?

- ❑ **Current Feedback > Anecdotal < Conclusive**
 - Little real experience beyond "traditional" truncation
 - Interest groups extrapolating without justification
 - Consumers Union response to CTA
 - AFP's negative response to US Treasury truncation initiative
- ❑ **Recent Initiatives Challenge Gloom and Doom Crowd**
 - Lower than anticipated admin returns
 - Zion's NetDeposit: .02% consumer, .01% commercial opt-out
 - Wells: .08% ACH "unauthorized" returns
 - Call center inquiries less than anticipated
 - Optout rates significantly lower than anticipated
 - Increased willingness to consider EBPP

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Top Ten List



**Truncation Broadens Corporate
Access to the Fed**



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Broadening Access to the Fed

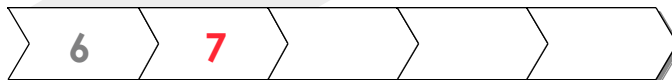
- ❑ **Probably But Not Definitely “No”**
- ❑ **“ODFI” and “RDFI” - Rules Emphasize “Depository” and “Financial Institution”**
- ❑ **Tradeoff: Internal Investment vs. Bank Fees**
- ❑ **Options will be explored:**
 - Credit card monolines
 - Industrial bank and other limited bank charters
 - Corporate credit unions
 - “Renting” ABA numbers (“FI” retains responsibility and risk, subject to service agreements)

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Top Ten List



**Only ARC Items Are Eligible for
RCK Return Processing**



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ARC & RCK Are Unrelated

- ❑ **RCK = Re-presented check entry**
 - "An ACH debit application used...to re-present a check that has been processed through the check collection system and returned because of insufficient or uncollected funds."
(NACHA Rules - 2002)
- ❑ **RCK Governed by Check, Not EFT, Law**
- ❑ **RCK Characteristics**
 - Single entry transaction, requires check writer notification
 - Limited to consumer checks < \$2,500, returned as NSF or uncollected
 - Two submission limit after initial return of paper
- ❑ **Limited Value as Risk Management Tool**

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Top Ten List



Truncation Is a Future Event



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Truncation Is a **CURRENT** Event

- 30 Year History of “Traditional” Truncation**
 - Credit union share drafts
 - Mutual fund checking
 - HECL and credit card checking
- 10+ Year History of ECP**
- RCK Available Since 1999**
- ARC and Other Truncation Forms Available Since 2002**
- CTA and Check21 Before Congress This Year**
- Fed’s CTAC And Other Services Fully Operational in 2003?**

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Truncation Is a **CURRENT** Event

- | | |
|--|--|
| <input type="checkbox"/> American Express | <input type="checkbox"/> Bank One |
| <input type="checkbox"/> Cingular Wireless | <input type="checkbox"/> Bank of America |
| <input type="checkbox"/> Mellon Bank | <input type="checkbox"/> Federal Reserve Banks |
| <input type="checkbox"/> Regulusgroup LLC | <input type="checkbox"/> JP Morgan Chase |
| <input type="checkbox"/> Wells Fargo Card Services | <input type="checkbox"/> Metris Companies |
| <input type="checkbox"/> Internal Revenue Service | <input type="checkbox"/> Zions Bancorporation |

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Top Ten List



**Truncation Will Reduce Lockbox
Operating Costs**



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Lockbox Cost Reduction?

- ❑ **Highly Channel Dependent**
- ❑ **Greater Complexity in Lockbox = Higher Processing Costs**
 - Depends on processor readiness
 - Workflow complexity - multiple cash letters
 - Software/re-engineering investment
- ❑ **Major Payment Receivers Have Aggressively Negotiated Check Clearing Costs Already - Little Wiggle Room**
- ❑ **Availability will improve - but how much?**
- ❑ **Return Item Costs Will Probably Decline**
 - Electronic vs. paper returns and re-presentation
 - More rapid return notification, generally
 - Admin returns, customer opt-outs and returns will be factors

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Truncation And Fraud

- ❑ **Check Fraud Loss: About 2 bp On Total Value of Checks Written, Or \$10 - \$14 Billion A Year**
 - FI share of check fraud losses: 5%
 - Business share of check fraud losses: 95%
- ❑ **Administrative Cost of Check Fraud: 5X - 10X Financial Loss (possible much more)**

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Top Ten List



Implementing Truncation Is a No-Brainer



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Very Much A “Brainer”

Changes Up and Down The Line

- ❑ Lockbox operations
- ❑ ACH bank and bank operations
- ❑ Corporate billing operations
- ❑ Corporate treasury

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Lockbox Operations

- ❑ **Multiple workflows**
 - Eligibility sorting
 - Application sorting
 - Single pass, two pass, when to separate, process?
- ❑ **Complex MICR parsing**
- ❑ **Image capture and export - one side or two**
- ❑ **Payment file outputs**
- ❑ **Document management**
 - Source document storage and destruction
 - Image archive and retrieval
- ❑ **Returns processing**

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ACH Bank Operations

- ❑ **Application Setup**
- ❑ **Application Processing**
 - Cutoffs
 - Post submission edits: adds, deletes, changes
 - Security
- ❑ **Managing Returns (Especially Admin Returns)**

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Corporate Billing Operations

- ❑ **Customer Notification**
- ❑ **Opt-in / Opt-out Management**
 - Tracking
 - Communication with lockbox processor
- ❑ **Education/Training**
 - Customer
 - Billing department personnel
 - Customer service/call center personnel
- ❑ **Documentation and Tracking**
 - Lockbox SLA compliance
 - Call center data access

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Corporate Treasury

- ❑ **Business Case Development and Justification**
- ❑ **Implementation Project Management**
- ❑ **Provider Selection - Lockbox Processor and ODFI**
- ❑ **Contracts and SLA's - Lockbox Processor and ODFI**
- ❑ **Service Pricing**
- ❑ **Performance Measurement and Cost Monitoring**
- ❑ **In-house changes**
 - Systems and technology
 - Procedural
 - Staff training

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Conclusions

- ❑ **Diversity of Opinion About ARC and Truncation, Generally**
- ❑ **Much Misinformation and Misunderstanding Remains**
- ❑ **Even Disinformation???**
 - Consumer Union
 - Banks concerned about item processing revenues
 - AFP
- ❑ **More Education and Assistance Required**
 - Analytic tools to quantify ARC costs and benefits
 - Risk assessment and avoidance
 - Business case development and justification
 - Project management support
 - Consumer education

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