



THE SHERATON COLONIAL
WAKEFIELD, MA

Check 21

From a Corporate Point of View

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Agenda

- Background
- What is Check 21?
- Impact on the Banking Industry
- Why do I care?
- Corporate Impact
- Q&A

Payments are big business!

- *In 2000, the U.S. payments industry earned \$195 billion in revenue and \$45 billion in pretax profits.*
- *Payments account for 41% of total net banking revenue.*
- *Consumer checking generates about one-third of a bank's retail deposit profits and covers a hefty share of branch and infrastructure related costs.*

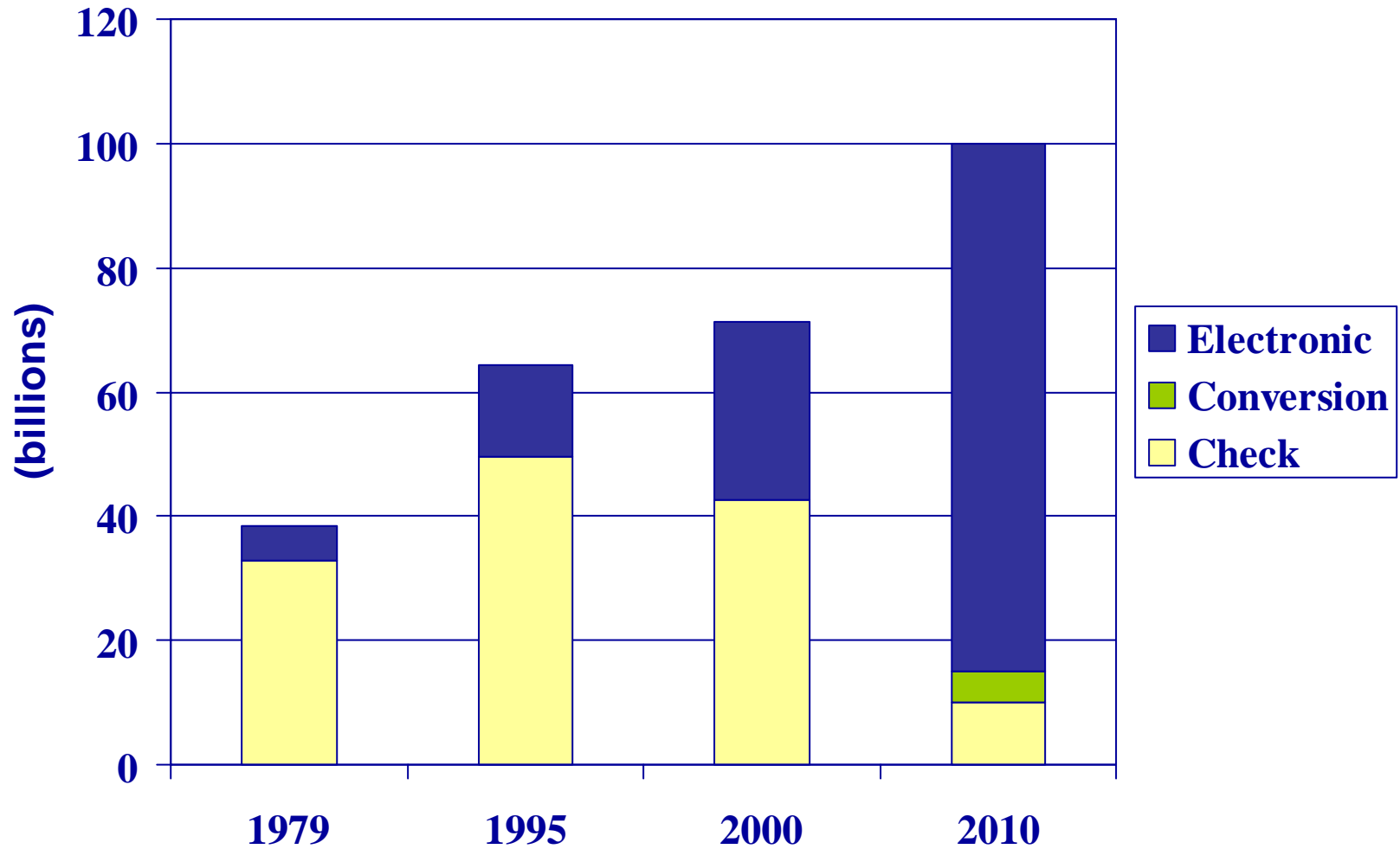
Sources: FDIC, US Banker, ABA, McKinsey, BCG

But the payments landscape is changing!

The long heralded “death of the check” may not be here yet ... but check volume is actually declining for the first time in US history.

- There were approximately 71.5 billion non cash retail payments made in the US during 2001. The size of the market has doubled in the last 20 years from 37 billion payments in 1979.
- Checks continue to be the predominant payment vehicle with about 60% of the market, with about 42.5 billion retail checks with a face amount of about \$39 trillion written in 2001.
- Credit card transactions represent approximately half of the electronic transactions with 15 billion transactions worth \$1.23 trillion in 2000.
- Debit cards were half the size of credit card market with 8.3 billion transactions for \$348 billion.
- ACH transactions were approximately 1/3 of the electronic transactions at 5.6 billion items, but represented over $\frac{3}{4}$ of the value at \$5.7 trillion.
- Source: FRB 2001 Retail Payments Study

U.S. Retail Payment Volume



Sources: FRB, ABA, Goba Concepts

And the impact is just beginning !

“Financial companies must adjust to the reality that check volume will steadily decline for the foreseeable future, along with check-based revenue. Lurking underneath this downward trend is an ominous implication that the checking cornerstone may be at risk as customers switch to providers with better electronic payment services. “

Source: American Banker November 8, 2002

Check 21 – A Brave New World!

123456789
01/04/2002
123456789012345

This is a legal copy of your check. You can use it the same way you would use the original check.

00530001831 01/03/2002 9446550091 1800539446

NOT NEGOTIABLE - DO NOT CASH
 JAMES C MORRISON
 MARY B MORRISON
 1765 SHERIDAN DRIVE
 YOUR CITY, STATE 04001

145
00-5789/0000
008902

DATE Jan 1, 2002

PAY TO the order of NORTH POLE, INC. \$ 295.45

Two Hundred Ninety Five and 45/100 DOLLARS

VOID - IRD TEST SAMPLE

DELUXE
YOUR CITY, STATE I2345

MEMO Goodies

⑆000067894⑆ 12345678⑆ 0145 ⑆0000029545⑆

⑆000067894⑆ 12345678⑆ 0145 ⑆0000029545⑆

0530-00183 01032002
 WACHOVIA BANK, N.A., COC
 CHARLOTTE, NC 1175-002
 1800539446

00530001831

>01000011< 01/02/2002
7815830233

JAN - 2 02

⑆031000011⑆
 FIRST UNION NATL SVC-013
 PHILADELPHIA PA 01022002
 7815830233

DO NOT SIGN / WRITE / STAMP BELOW THIS LINE
FOR FINANCIAL INSTITUTION USAGE ONLY

ENDORSE HERE:
 FOR DEPOSIT ONLY
 FIRST UNION NATIONAL BANK
 ACCOUNT 1234567890123
 NORTH POLE, INC.

⑆0530001831 01/03/2002
 1800539446
 123456789 01/04/2002
 123456789012345

↓ Do not endorse or write below this line. ↓



Check 21 Defined

- The Check Clearing for the 21st Century Act
 - Proposed by the Federal Reserve as new federal law
 - First time the Fed has ever proposed legislation
- Effective October 28, 2004 - ie. 12 months after the day of enactment (October 28, 2003)
- The purpose of the Act is to :
 - Facilitate check truncation by authorizing substitute checks
 - Foster innovation in the check collection system without mandating receipt of checks in electronic form
 - Improve the overall efficiency of the Nation's payments system
- All domestic checks are eligible!

Check 21 Will Change Everything

Initial estimates are for 15% - 20% reduction in direct check processing costs.

- Check Transportation
- Check Processing Costs
- Exception Processing
- Fraud

An Evolutionary Revolution!

Estimates of total annual cost savings from check truncation at the point of deposit are well in excess of US \$1 billion.

- Teller Deposit Processing
- ATM Deposit Processing
- Internal Courier/Armored Car Costs
- Fraud
- Statement costs
- Other Operational Improvements

But the Cost May Be Even Larger!

We estimate that the banking industry will invest in excess of US\$10 Billion over the next five years

- Immediate cost for regulatory compliance
- Majority of banks are not fully image enabled
- Split processing will complicate back office issues
- Significant changes in processes and procedures are needed to realize the full benefits

And that's only part of the story!

Check 21 will result in significant revenue and margin pressure for the banking industry

- Reduced fee income
- Margin pressure
 - Increased costs/reduced margins
 - Movement to competing products
- Potential loss of Return Fees
- Potential loss of customers
- Reduced float
- Balance sheet impacts

Multiple Strategies Are Available - for Banks

- Business as usual – except it isn't
- Image returns
- IRD/Image presentation for selected endpoints
- Image processing for selected customers
- Full truncation with image wherever possible
- New products
- Competition for "new" customers
- Insourcing/Outsourcing

Why Do I Care? It's a Banking Industry Problem

Check 21 will have a variety of direct and indirect impacts on anyone who uses US payments systems!

- Procedure changes
 - Some of your checks will become substitute checks
 - Return item procedures are likely to change

Why Do I Care? It's a Banking Industry Problem

Check 21 will have a variety of direct and indirect impacts on anyone who uses US payments systems!

- Procedure changes
- Service disruptions
 - ARP/Positive Pay may be problematic
 - Statement cycles may be extended
 - Customer service/problem resolution may take longer
 - Product changes/enhancements may be delayed

Why Do I Care? It's a Banking Industry Problem

Check 21 will have a variety of direct and indirect impacts on anyone who uses US payments systems!

- Procedure changes
- Service disruptions
- Price changes
 - Bank margin pressures may result in attempts to increase prices
 - Physical check processing will become more expensive

Why Do I Care? It's a Banking Industry Problem

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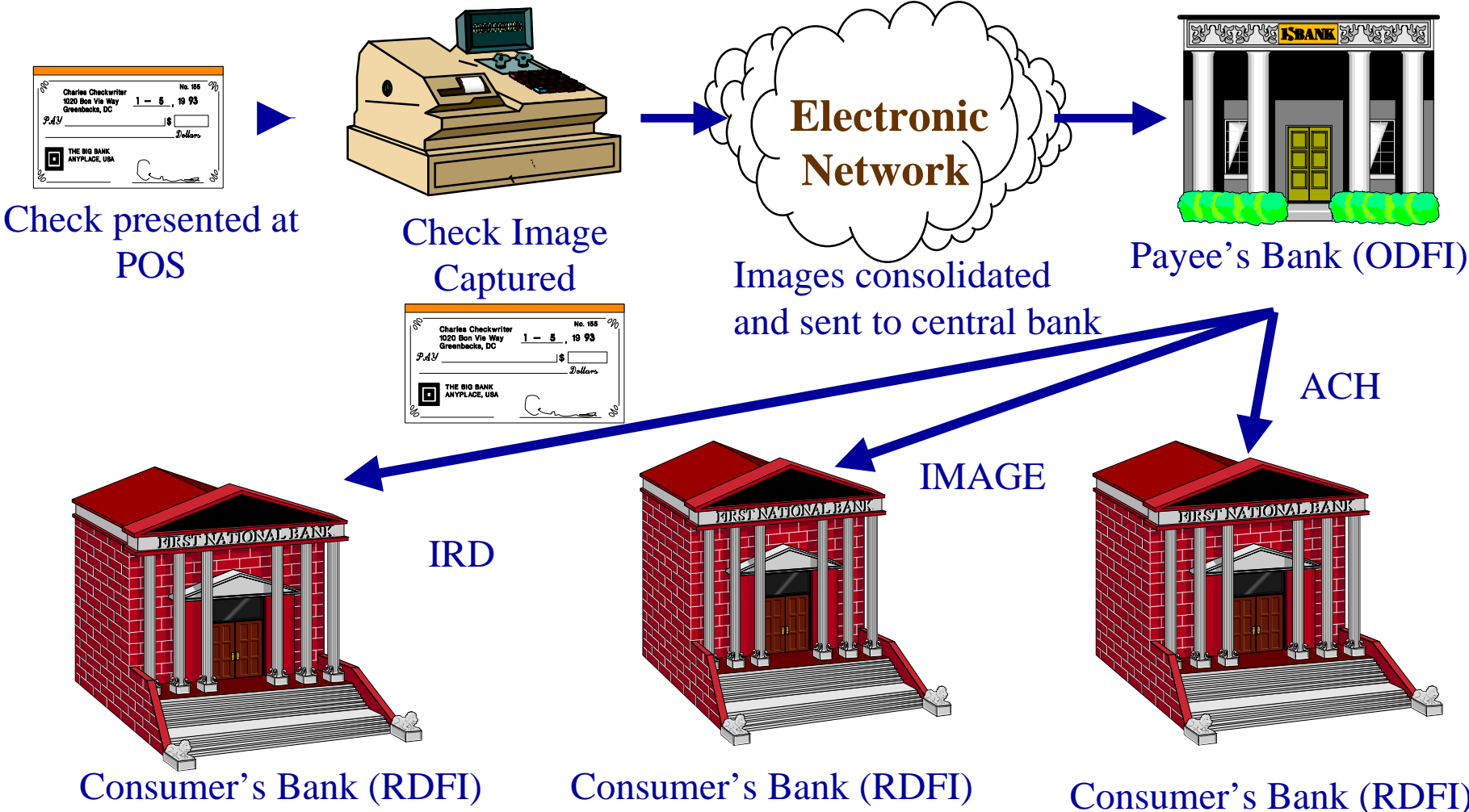
- Procedure changes
- Service disruptions
- Price changes
- Float impact
 - Disbursement float *will* be reduced
 - Collection float *may* be reduced
 - End result will be pressure on available cash

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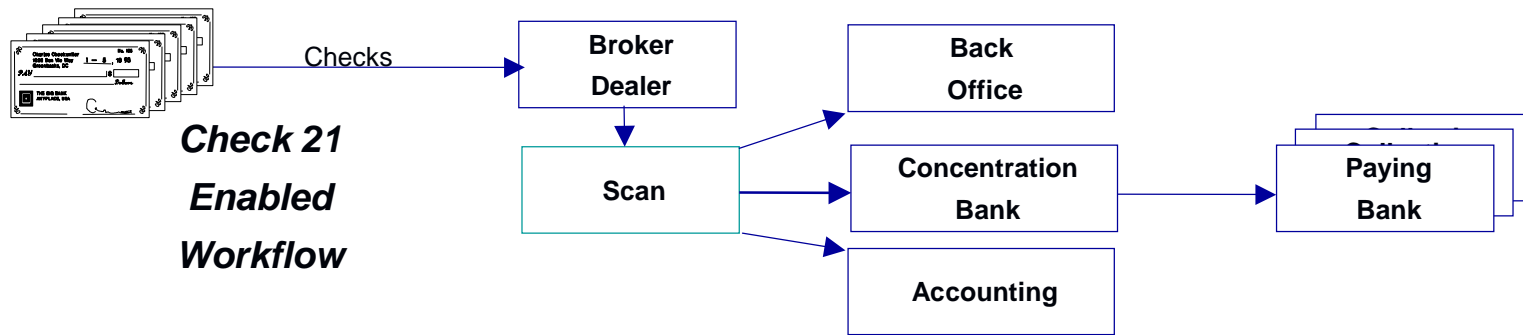
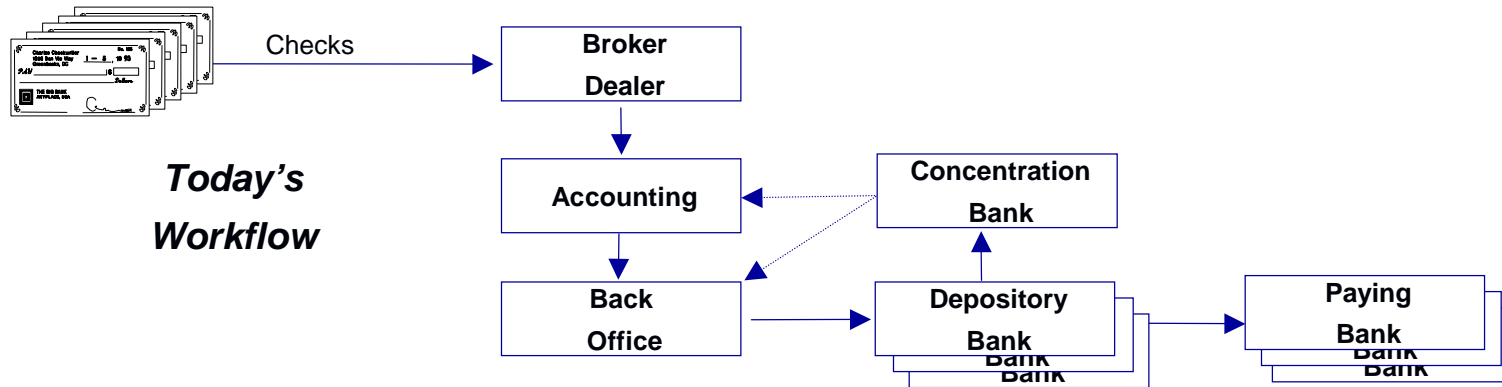
- Procedure changes
- Service disruptions
- Price changes
- Float changes
- New services
 - Push towards image statements
 - Image Returns
 - Consolidated Deposit Services

Consolidated Deposit Services



But bank float is only part of the story

Redesigned internal processes



Why Do I Care? It's a Banking Industry Problem

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- Procedure changes
- Service disruptions
- Price changes
- Float changes
- New services
- New banks/fewer banks

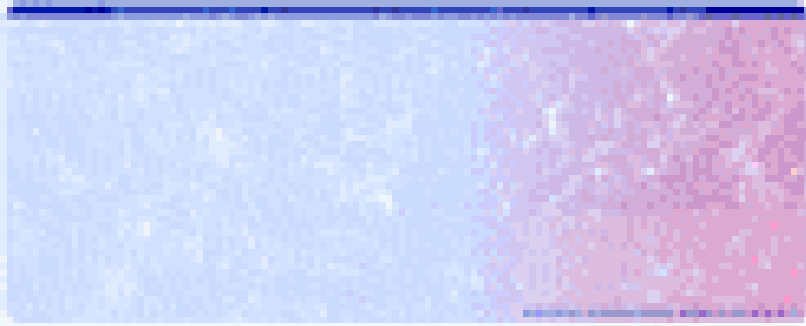
Why Do I Care? It's a Banking Industry Problem

Check 21 will have a variety of direct and indirect impacts on anyone who uses US payments systems!

- Procedure changes
- Service disruptions
- Price changes
- Float changes
- New services
- New banks
- New risks
 - Check Fraud
 - Consequential Damages

Check Fraud

Are you expecting this?



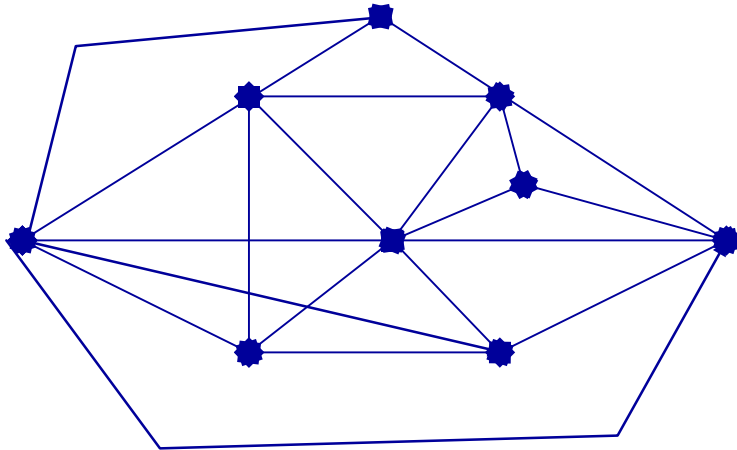
Or this?



More importantly, what will your local prosecutor expect??

Closing Thoughts

In economic terms check processing is a **mature network system**, very similar to railroads, airlines, and telephones



- High fixed cost
- Aging infrastructure
- Low marginal revenue
- Complexity grows with time
- High maintenance/repair costs
- High dependence on network externalities

But network systems **need continuously increasing volume** to maintain overall profitability, are subject to predatory pricing and are highly vulnerable to new more efficient competitors.

Closing Thoughts

Network transitions are high risk periods that favor:

- 1. *Early Adopters*** – with the right vision
- 2. *Flexible competitors*** – able to adapt to changing times
- 3. *Low overhead operations*** – outsourced processing to convert fixed to variable costs
- 4. *Integrated providers*** that can optimize performance and rapidly migrate volume to replacement network

The common element is a long term strategic vision combined with thorough understanding of customers, partners and operating costs.

Closing Thoughts

- The economics are complex and vary by participant and by market strategy
 - Potential savings are large and (hopefully) repetitive
 - Initial implementation costs are just as large but are essentially one time
 - Issues are very different for disbursement versus collections
- Crystal balls may be cloudy, but planning for the future is critical for success
 - Strategy rather than tactics
 - Knowing where you are is key to planning where you want to be

Additional Resources

- www.treasuryalliance.com
- www.frbservices.org
- www.eccho.org
- www.nacha.org
- ecc.nacha.org
- www.x9.org
- www.bitsinfo.org

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