



CHECK SCANNING IN THE US MARKET

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The Check Clearing for the 21st Century Act (Check21) was signed into United States law on October 28, 2003, and became effective on October 28, 2004. Check21 is designed to foster innovation in the American payments system and to enhance its efficiency by reducing some of the legal impediments to check truncation. The law facilitates check truncation by creating a new negotiable instrument called a substitute check (Figure 1), which permits banks to truncate original checks, to process check information electronically, and to deliver substitute checks to banks that want to continue receiving paper checks. A substitute check is the legal equivalent of the original check and includes all the information contained on the original check. The law does not require banks to accept checks in electronic form nor does it require banks to use the new authority granted by the Act to create substitute checks.

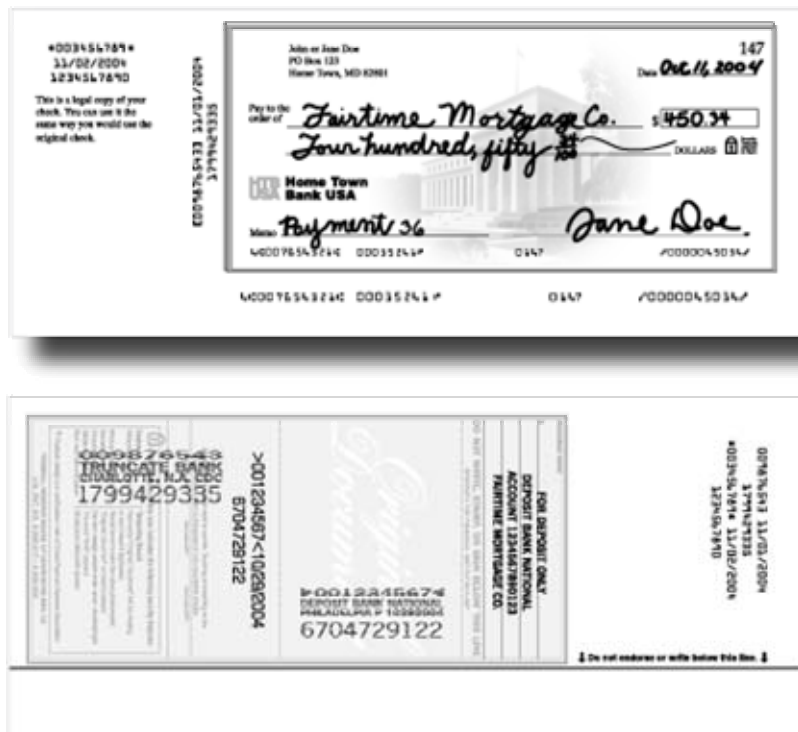


Figure 1 Example of a Substitute Check

Check21 has cleared all hurdles related to check truncation, and the US financial industry is making slow but steady progress in establishing standards¹ and setting up infrastructures² for image exchange. Image

¹ Standards for substitute checks are in place. Standards for image exchange and interoperable IQA standards expected to be completed by end of 2005.



exchange is still in the early adoption stage. In May 2005 the US Federal Reserve reported that only 650K of the 50 Million³ checks they clear per day are being exchanged by images or substitute checks.

The US major banks' initial focus has been to prepare their existing internal infrastructures and centralized capture and inclearing systems to be compatible with image exchange. The majority of the capture systems used by major banks are IBM 3890 (High speed sorters), and a portion of those are being upgraded with image cameras to enable image capture for image exchange. Their inclearing systems are being upgraded to accept images as well as paper items. It is expected that it will take many years for inclearings to be 100% image exchange due to the use of substitute checks, and the voluntary nature of Check21 adoption.

CHECK PAYMENTS IN THE US MARKET

Check payments continue to be very popular in America with nearly 38 Billion checks issued in 2003. The Federal Reserve has measured a 4.3% annual decline in checks paid⁴ between the years 2000 and 2003. Checks remain popular for their convenience and associated float benefits.

FINANCIAL INSTITUTIONS SHIFT TO DISTRIBUTED CAPTURE

Although the initial focus is upgrading their centralized operational centers with imaging, the US financial institutions are seeing the benefits of shifting from the traditional centralized capture model using high speed reader sorters to a distributed capture model using small table top check scanners. Remote deposit seems to be getting the next priority focus as the banks are seeing revenue opportunities associated with increased services and increased market share. Remote deposits overcome geographic limitations, greatly expanding the market a bank can serve. This is creating more competition between the major banks, as a west coast bank can now offer bank account services with later cutoff times to east coast customers.

Branch capture seems to be getting the least attention for now except for a few early adopters. The majority of the banks are planning branch capture implementations in 2006 and later depending on the actual implementations of the image exchange infrastructures and remote deposit implementation projects.

Remote deposit is creating a marketing frenzy, but the reality is that only a few of the larger banks are piloting this service directly to a handful of customers. Other banks are offering these services through ASP

² Major Electronic Image Exchange Networks are being established by the Federal Reserve, SVPCo, and the Endpoint Exchange. Image exchange volumes are currently small but growing.

³ Using 2003 statistical data, there are approximately 152 Million checks per day written with 116 Million checks per day cleared between banks. The US Federal Reserve claims to be clearing 50 Million of those (2004 data point). The other 66 Million will be cleared directly between the major banks and through other processors like FiServ and EDS.

⁴ Reference "The 2004 Federal Reserve Payments Study." Note: Checks converted to ARC are not counted as checks paid.



models, but again with a limited number of customers. The banks are expecting a high rate of adoption for this service, but it is still to be seen if the market adoption rate meets expectations.

CHECK CONVERSION IN THE US MARKET

America has established electronic payments networks designed for high-volume low-value payment transactions. These payment networks are referred to as ACH – Automated Clearing House, and are regulated by NACHA – National Automated Clearing House Association. Common ACH payments are payroll deposits, dividend payments, and authorized debits for bill payments. The volume of ACH payments is growing at the rate of 18% annually with over 12 Billion⁵ in transactions expected to be cleared in 2005.

One of the ACH payments, called ARC – “Accounts Receivable Check,” allows a receiver of a paper check payment to convert the payment to an electronic ACH transaction. This practice is being employed at POS and remittance processing. A notable retailer that uses ARC at the POS is Wal-Mart. NACHA reported in 2004 that 1.2 Billion checks⁶ were converted to ACH electronic transactions. This is an increase of 600% over the previous year. Opinions are that ARC volumes will grow to around 3 Billion transactions per year in the next 2-3 years, and then taper off as check volume declines.

NACHA regulations only permit consumer-type checks to be converted to ACH. High value commercial/government-type checks are not allowed for conversion as these typically go through authentication verification processes that require either an image or the original paper.

An ARC transaction only requires the MICR codeline of the check to be captured. For audit and non-repudiation purposes there is a trend to also capture the front image of the check. The image is not exchanged, but will be retained for a short period (30-90 days); long enough to ensure the transaction has cleared without exceptions. The ACH networks do not provide any image exchange capability. Table top check scanners are being deployed for POS ARC capture. Check scanners used in ARC conversions are typically MICR only or MICR and front image only.

REMITTANCE PROCESSING IN THE US MARKET

The majority of bill payments in the Americas are paid by check through the mail. High volume⁷ billers typically use a Lockbox Service provider for processing their received payments. The volumes of this type of payment are in a steady slow decline as customers switch to online bill payment and authorized debits. Lockbox service providers are also taking advantage of ARC conversions.

⁵ Reference NACHA: <http://www.nacha.org/News/Stats/stats2005/2nd%20Quarter%202005.pdf>

⁶ Reference NACHA: <http://www.nacha.org/news/default.htm>

⁷ High volume billers are typically utility companies (gas, water, cable, satellite, internet service, telephone, cell phone service providers)