

REGULUS

Headquartered in Napa, California, Regulus is the nation's largest single provider of bill presentment and remittance processing. Our national network of print and lockbox facilities is strategically aligned with the USPS to move both outbound and inbound customer transactions the fastest and most innovative way possible.

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Radical change continues to rouse the payments industry. Paper payments are in a long-term decline. Alternative electronic payments are gaining ground daily as an acceptable means for customers to transact as almost every major company pushes paperless channels.

Check volume is shrinking at a steady pace with about 65% of consumers paying by check, and about 35% now paying through some means of electronic payment. Some aggressive companies are achieving even more impressive rates—more than 50%—by doling out incentives in exchange for electronic payments. Still, paper remains the most popular payment channel—one the industry started tackling differently in 2005.

Luring Customers

Many interested parties are making great strides in luring consumers towards paying electronically, through the Internet, the phone, or ATMs. Recurring ACH account debits dominate electronic choices with credit cards and pay-by-phone channels climbing in popularity because of pure customer convenience. Despite the excellent job done getting customers to agree and pay via alternate means, the issue remains that two-thirds of them still prefer to pay by paper.

But, after years of trying to change consumer behavior, it appears a different tactic

The Triple Force of Electronic Check Clearing

ARC™ Check 21™ Image Exchange

By Sandra P. Williams

from new collection methods may provide just the necessary push towards electronic payments. Changes last year in clearing regulations have teed up new ways to tackle the remaining paper payments that do not need consumer consent. ARC, Check 21 and Image Exchange present alternate electronic vehicles designed to increase the pace of electronic conversion with an underlying goal to eventually make consumers more aware and amenable to new payment forms.

This triple force will overhaul the expensive and antiquated check-clearing process that transports paper checks across the country. The trio will not only cause a re-engineering of the nation's check processing system, but will also drive most companies to

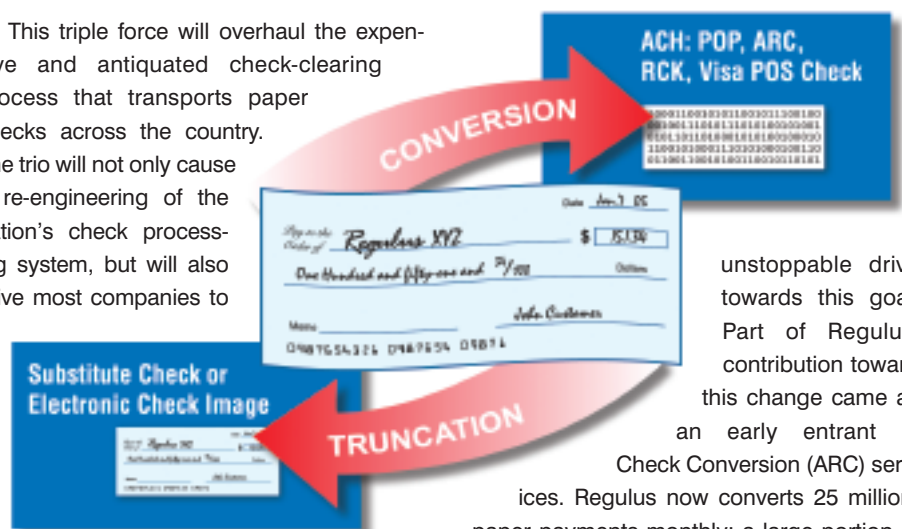
completely reexamine cash collection strategies. Changing conditions could tip the scales in one fell swoop, making the business case much stronger for outsourcing.

1. Check Conversion (ARC): converts original paper check to an electronic Automated Clearing House (ACH) settlement entry governed by NACHA.

2. Check Truncation (Check 21): truncates original paper check to image for settlement either electronically or via substitute check for non-image able parties.

3. Image Exchange: the exchange of images within clearing networks (bank groups or 3rd party processors) for electronic, same-day and next-day, settlement.

Industry experts express the ultimate goal as 100% electronic payments processing across the country with "real-time posting, real-time exchange, and real-time (guaranteed) settlement." Yes, it will take time, perhaps many years, but there is an



unstoppable drive towards this goal. Part of Regulus' contribution toward this change came as an early entrant in Check Conversion (ARC) serv-

ices. Regulus now converts 25 million-paper payments monthly: a large portion of all ARC transactions in the entire industry. Checks conversions continue to soar with annual transactions crossing the 2 billion mark in 2005.

Check Conversion: ARC

Companies can now notify a customer of their choice to convert a check to an electronic entry that can be settled and returned through the Automated Clearing House (ACH). While consumer notification is required, the company, initiates this service

as opposed to persuading customers to participate.

ARC is already a hit. Many of our largest clients see enormous financial and operational benefits from deploying this proactive electronic clearing service. The most quantifiable benefits are:

- Faster cash collection
- Rapid return item receipt
- Fewer NSF return items
- Lower bank fees
- Late fees collected sooner or waived fees more often
- Extended processing hours
- Earlier notification of potential fraud
- Consolidation of bank relationships
- Increased accuracy
- Speed in research and adjustments (no longer waiting on check copies)

ARC, thankfully, is having little customer service impact with conversion of the larger dollar payments, like mortgage loans, not even causing calls in support centers to climb. Immediate image access plays a major role in the viability of this service as well.

A notable limitation to ARC is that only consumer checks were eligible for conversion until recently. Now NACHA has approved conversion of all six-inch business checks under \$25k dollar limit. Traditional, nine-inch business checks can also be eligible if companies choose to remove the auxiliary on-us field on the MICR line.

Check Truncation: Check 21 and Image Exchange

Check 21 is how all US-drawn checks, consumer and business, can take an automated route for clearing. Banks can exchange electronic images of checks in place of paper checks. Check 21 will be the catalyst for massive change in the collection process. Built to expedite check clearing, substitute electronic check images can be transmitted to any clearing point for deposit, minimizing float, and clearing costs. Unlike ARC, transactions are processed through existing check processing channels governed by the UCC. Checks not eligible for ARC conversion today will now be able to continue in the form of images and data.

Foregoing the substitute check entirely by only exchanging the images for clearing is at

the core of Check 21's future goals. Right now, that is a huge issue. Even for the remaining paper payments, many banks are not ready to send and receive electronic images. Pricing varies widely among providers trying to set industry direction. Many in the industry are in "a wait and see" mode. How long it takes before a meaningful portion of financial institutions is ready to send and receive electronic files is anyone's guess. Check 21 and image exchange may take years to gain real traction, while paper payments will continue to drop. Again, Regulus is doing its part to drive change with its image cash letter service already active with several major clients.

Paperless solutions bring broader and more complex choices that may mean a change in course for all players. Under Check 21, the fundamental step of physically taking cash letter deposits to a local bank facility is being turned upside down with the onset of electronic settlement. Banks understand too that the day of dependence on centralized bank centers is fading. Geographic borders disappear. Companies are now able to consider a mixed collection strategy that takes advantage of all three settlement methods (ARC, Check 21, and Image Exchange) to achieve the best routing and lowest cost. The float—the time between when a check is deposited and when the amount is actually available for company use—could be reduced from days to hours as a result of these new clearing methods.

Taking time to decide how best to clear incoming checks is worth the extra effort. For example, by determining the top two or three institutions on which customer checks are drawn, multiple depositories can be used instead of just one. One-day collectable funds now become available immediately upon deposit with more banks. This electronic environment adds another advantage with extended processing windows not dependent on normal clearing deadlines. A processor must possess the internal expertise to manage the float component, while also dealing with reconciliation and others issues that may open up. All aspects of any major change must be carefully considered.

Without doubt, basic questions on who, what, where, and how most likely will be answered differently with new ways of pre-

senting image-based cash letters. The lock-box location, the number of collection sites, as well as the current provider, may be modified to access the new accelerated clearing channels. But all these decisions may be just too much to cope with for in-house payment processing shops facing drastic makeovers. At times like this, firms need to turn to outsourcers for more flexibility, expertise, and solutions in a shifting marketplace.

Check 21: Remote Deposit Capture

Currently, there is a buzz in the industry around remote deposit capture, in other words, capture and conversion to electronic images at the first place a check is originally received: a perfect fit for businesses receiving large value checks at nonpayment locations. Consider all the places checks are taken for loan applications or other major customer activities that are at remote offices or locations. Initially, only smaller volumes and high dollar checks are slated for this service, but it will expand to future higher volume clients. Watch this one as a potential blockbuster service as another offspring to Check 21.

Risk

Reengineering anything is fraught with risk. A move toward image-based payments and clearing methods, and away from paper, affects every aspect of internal workflows. Each step in the paper process requires an equivalent one in an image-based approach. Reevaluations of equipment, staffing, backup, redundant systems, fraud controls, service levels, and even negotiated bank pricing are necessary. Shifting to image settlement is not simple, requiring strict quality control features around capture, storage, retrieval, and file creations for adequate operations. While images provide automation and faster detection, the transition period is critical. Fraudsters thrive in unsettled times. Benefits can be realized, but all these changing conditions bring new twists to risk management.

Regulus will actively lead the way for new solutions while paper and electronics continue to converge.

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