

In Depth View

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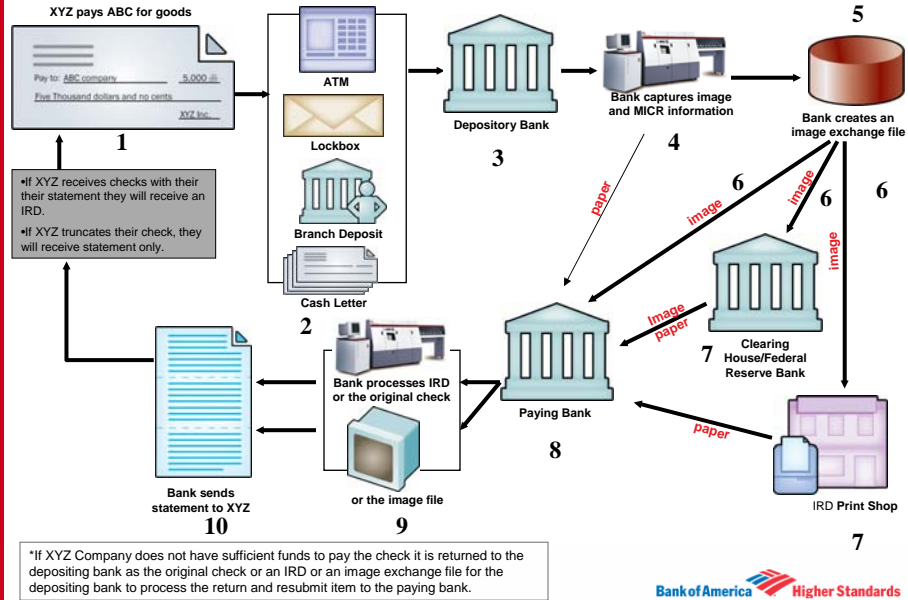
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Agenda

- In Depth View
 - New Clearing Stream
 - What is the Banking Industry Doing?
 - Impacts and Solutions
 - Differentiate check truncation vs. check conversion
 - Choices Given Your Business Model and Needs
 - Summary

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Potential Clearing Flow with Check 21



What is the Banking Industry Doing?

Before October 24 October 2004 Now-18 Months Eventually

Traditional
paper-based
processing

What
happened?
Business as
usual
Some checks
won't be
returned in
statements

Expect:
New products
from banks
New fraud
control tools
Remote
deposit
capture
capability
Image
Cashletter

Most banks
will exchange
images
Expedited
check
clearing?

The Federal Reserve Bank is...

- Sent its first image transmission on 11/22
- Developing image quality standards
- Experiencing a decline in check volume
- Consolidating check processing sites

Financial institutions are...

- [Most are] focusing on minimum compliance
- Continuing to invest in image technology and infrastructure
- Developing image quality standards
- Creating image clearing networks with industry groups and 3rd party processors
- [A few banks are] piloting image exchange
- Experiencing a decline in check volume
- Some are consolidating check processing sites
- Expanding product offerings

How Check 21 Could Impact You

- You could receive a substitute check
 - If you get checks back with your statement
 - Or, when deposited checks are returned unpaid & charged to your account
- You may experience accelerated clearing of checks
 - Checks you issue will begin to clear faster over time
- You may notice the loss of some anti-fraud check features on the substitute check

What will not change:

- Cash positioning
- Controlled disbursement
- Account reconciliation
- Positive pay

Solutions: Fraud Solutions for Check 21

Positive Pay with payee name verification

Secure seals

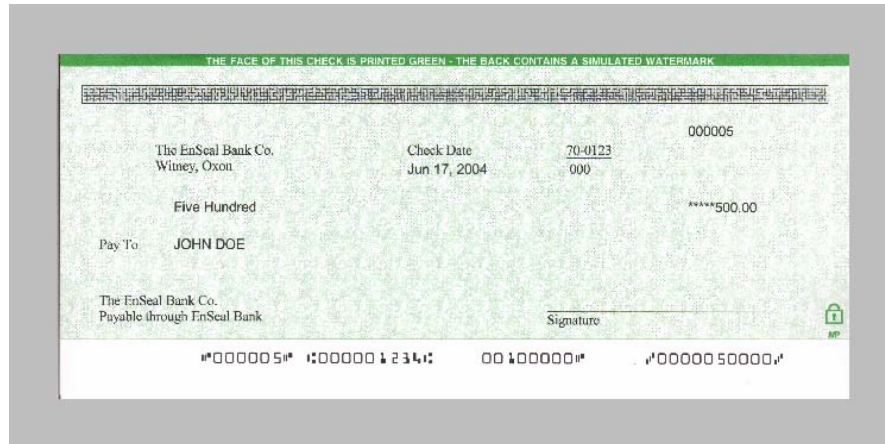
- Allows you to electronically submit payee name information as part of your check issuance file
- Allows you to include information in a secure seal encoded on the face of the check instead of in the image file
- The seal is a intricate pattern of lines containing encrypted account number, check number, dollar amount and payee name

Digital interrogation

- Our positive pay system decrypts the secure seal and “digitally interrogates” or analyzes check images and data to determine if any information has been altered

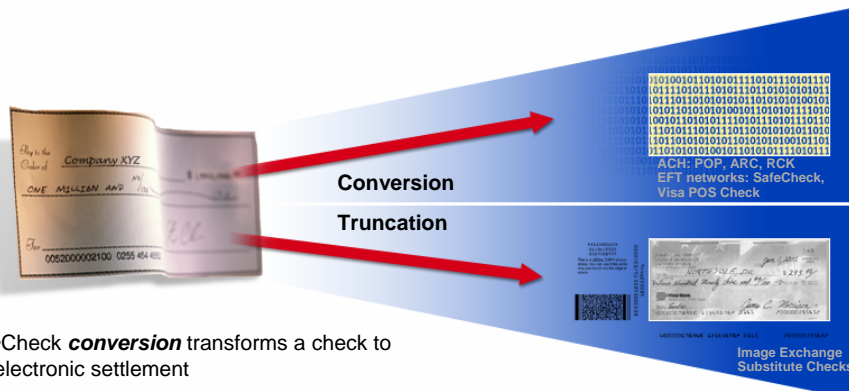
Enhanced Positive Pay service will be one of the best tools to help fight check fraud even after the original check has been transformed to check image or substitute check.

Sample digital seal (seal in border)



Check Payment Transformation

Check **conversion** and check **truncation** are distinct alternatives to transform a check



- Check **conversion** transforms a check to electronic settlement

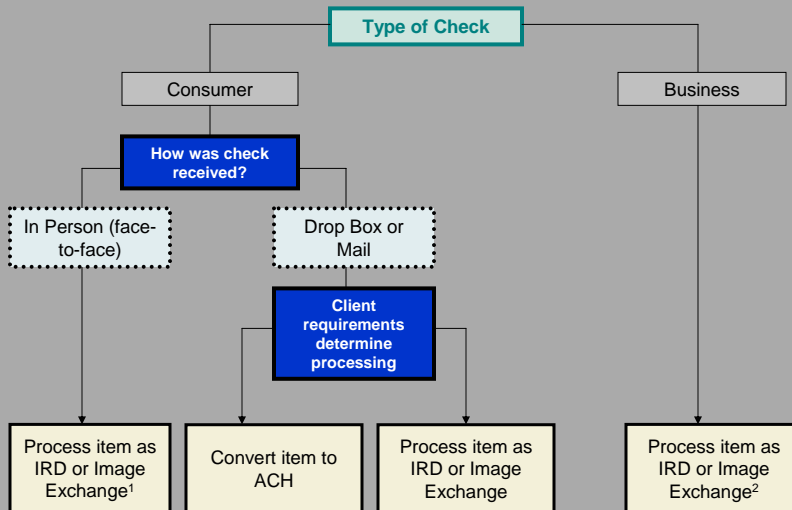
Vs.

- Check **truncation** transforms a check to image-enabled electronic or paper settlement

Essential Check Transformation Facts

	Check Truncation	Check Conversion
Definition	Check truncation transforms a check to paper settlement through a substitute check	Check conversion transforms a check to electronic settlement e.g. through NACHA as an electronic entry
Regulatory	Preserves the check's legal standing When check is truncated and turned into a substitute check, it is still considered a check and continues to be governed by the UCC	Changes the check's legal standing Once converted, the transaction is no longer governed by UCC, but may also be covered by Reg E
Eligibility	For a substitute check: <ul style="list-style-type: none"> All checks Requires no additional customer authorization Has no dollar limits 	<ul style="list-style-type: none"> Consumer checks only Requires customer authorization/notification Some transaction types have dollar limits (RCK)
Timing	Requires bank industry development As of October 28, 2004, banks are required to accept a substitute check for processing. Many banks will offer check truncation solutions to clients.	Available today Banks provide check conversion solutions to clients today.
Impact to Check Writer	<ul style="list-style-type: none"> Substitute checks returned instead of original check. New fraud detection devices will be needed for paper-based anti fraud controls 	<ul style="list-style-type: none"> Item might not be recognizable on statement. Inability to reconcile check disbursements
Operational considerations	No change needed unless client wants to submit an image cash letter for electronic deposit (Clients using image cash letter must be able to send file in X9.37 file format)	<ul style="list-style-type: none"> Ability to convert paper checks to an electronic deposit is required Ability to capture and store image of converted items (ARC only) is required A process to handle administrative returns is required & opt outs

Choices Given Your Business Model & Requirements



¹NACHA rules prohibit the conversion of consumer checks to ARC that are received face-to-face

²NACHA rules prohibit the conversion of business checks to ACH

Check Transformation Checklist

- Understand where transforming the check will help your business
 - Will check transformation help us meet our working capital objectives
 - How many payment processes can/should you operate
- Review the check transformation options available
 - Conversion capabilities that exist only work well when a high percentage of your customers are consumers
 - Does there necessarily have to be a single solution
 - Are check conversion and check truncation mutually exclusive
 - How can check conversion and check truncation ultimately work together
- Choose the check transformation solution that works best for your business
 - Least costly option
 - Option that provides least disruption
 - Finality of payment
- Know your customers
 - How should you notify and educate your customers
 - Have you anticipated customer reaction
 - Are you prepared to handle customer service
 - What about the opt-out provision
 - Understand their payment preferences

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In summary . . .

- Check 21 went into effect on October 28 of last year.
- The industry is developing new solutions around check transformation to help clients increase efficiencies and reduce operating costs and risk.
- Enhance your fraud protection
- Understand where you gain the most benefits from check transformation.
- There are key differences between check truncation and check conversion.

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EXPO L.A. SYMPOSIUM 2005:

-Strategic Implications of Check Electronification on the Remittance Process

May 2005

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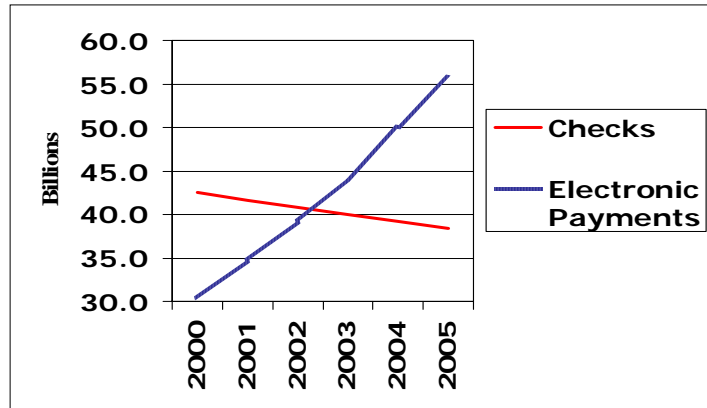
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Agenda

- State of the Industry
- Overview of electronic check models
 - Check 21, substitute checks and IRDs
 - Image exchange
 - ACH check conversion: ARC, POP and RCK
- New collection alternatives
- Strategic realities
- Payments Optimization
- Conclusions



Electronic Payments Exceed Checks in 2003



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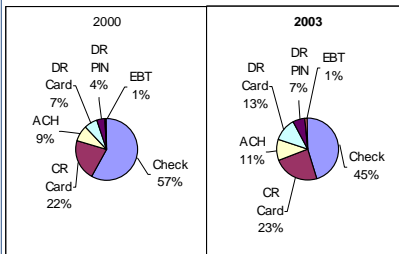
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Compiled by NACHA; Sources - NACHA, Federal Reserve, ATM & Debit News, CHIPS

2004 Federal Reserve Payment Study



	2000	2003	CAGR
	#'s in Billions	#'s in Billions	
Check	41.9	36.7	-4.3%
CR Card	15.6	19.0	6.7%
ACH	6.2	9.1	13.4%
DR Card	5.3	10.3	24.9%
DR PIN	3.0	5.3	21.0%
EBT	0.5	0.8	15.4%
Total	72.5	81.2	3.8%



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- Electronic payments surpassed checks in 2003.
- Checks 45% of non-cash transactions, from 57%.
- Overall transactions grew by ~9 billion payments from 2000-2003.
- Check declined by 5.2 billion items (-4.3%).
- Electronic transactions grew rapidly reflecting an overall growth in transaction volumes as well as a shift of cash payments to electronics.
- Debit cards grew most rapidly, accounting for over half of the overall growth.
- ACH grew by 13.4%, up 2.9 billion.
- Credit Cards grew moderately at a growth rate of 6.7%, or 3.4 billion transactions.
- EBT grew by 15.4% to a total of 800MM transactions.

ACH - Highlights of 2004 and Type of Transaction Volume



Highlights of 2004

Volume	12.0 billion
Value	\$28.6 trillion
Number of Companies	5.0 million
Consumer Participation	145 million

Types of ACH Payments 2004

	Volume (Billions)	Growth
Direct Deposit	3.4	6.4%
Direct Payment	2.2	8.6%
B2B	1.5	11.3%
E-Check	2.0	112.6%



*Transaction volume reflects network transactions only and therefore excludes on-us volumes
Compiled by NACHA; Sources - NACHA, Federal Reserve

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Check 21

- On October 28, 2004, the Check Clearing for the 21st Century Act, more commonly known as Check 21, became law.
- This legislation was pursued as a result of the events surrounding September 11, 2001.
- Creates the legal equivalence of the original check and a substitute check
- The Federal Reserve's objectives:
 - Facilitate check truncation and promote the use of electronics
 - Foster innovation without mandating receipt of images
 - Improve overall efficiency of the nation's payments systems



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Substitute checks

- A substitute check is the legal equivalent of the original check for all purposes.
 - Contains legible image of front and back of check
 - Conforms to industry standards (MICR, physical characteristics of check)
 - Bears indemnity legend
 - Includes all endorsements
 - Identifies creating party



Check 21

- The use of substitute checks does not require an agreement between parties.
- Any party receiving a substitute check must accept it, including the parties in forward collection process and in returns (unpaid) process.
- All checks may be converted to substitute checks, including commercial checks, government checks, money orders, traveler's checks, etc.
- Provides for expedited re-credit for consumers
- Check 21 DOES NOT:
 - create the legal equivalence between an "image" and the original check
 - require banks to accept or send images
 - mandate image exchange as the industry standard

Electronic check presentment (ECP)

Today: ECP with physical checks to follow

- Facilitates more efficient processing by allowing the paying bank to electronically receive MICR data ahead of the physical checks.
 - The paying bank debits their customer accounts on the day of receipt of the MICR file (a day sooner than normal).
 - Physical items are delivered later, then are available for exception handling (NSF, stop payments, etc.), and may be returned with statements.

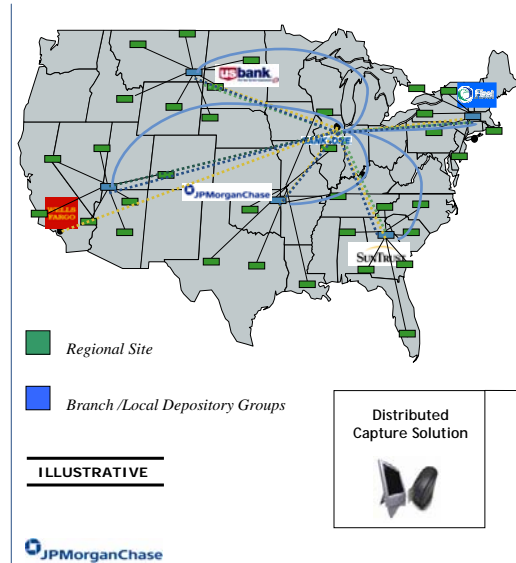
Tomorrow: ECP with image exchange

- Facilitates the same process as current ECP models; however, images of the checks will be exchanged instead of the physical checks.
 - Images are available for exception handling (NSF, stop payments, etc.) and for enclosure in bank statements.

ACH check conversion

- Single-entry ACH debit, consumer checks only
- Check becomes "source document," no longer a check, but an ACH regulation E transaction
- Accounts receivable conversion (ARC)
 - Check payment mailed to biller/lockbox or placed in drop box
 - Notice on bill equals authorization
 - Check is imaged and destroyed within 14 days; image retained for two years
- Point of purchase (POP)
 - Individual presents check at pay window or point of sale
 - Authorization required at time of transaction
 - Consumer-as-keeper current model

New collection alternatives: distributed capture

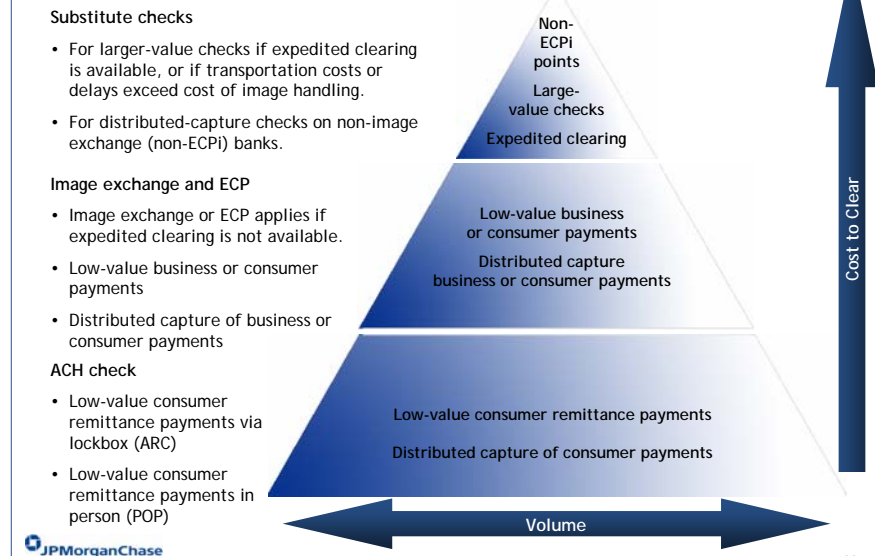


Scenario: Corporate client collecting \$250 in-person and drop box payments in numerous locations, consumer and corporate payments

- **Option 1** Maintain local depository relationships in every market, reconcile branch deposits, forecast cash and concentrate into headquarters
- **Option 2 ACH check conversion (POP or ARC):** consumer items (roughly 80 percent of items); no business items
- **Option 3 ECP image exchange:** electronically deposit into headquarters
- **Option 4 Check 21:** If check cannot be exchanged or converted to ACH, capture at branch and deposit substitute check in concentration bank

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Optimization allows you to pursue the most beneficial payment channel



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Strategic realities

- Image exchange (ECPI) is the desired end-state, but is dependent on adoption by thousands of banks; this will take many years.
- Substitute checks may prove to be more expensive than traditional checks, and at current interest rates may prove feasible only for certain transactions (large value, transportation delays).
- ACH-check is growing at triple-digit rates, but still accounts for less than 10% of checks in the bill payment environment.
- Check volumes are declining, putting more pressure on operating costs and site consolidations.
- Most checks (91%) are under \$1,000, and will require physical check processing until image exchange is more broadly in place.
- Coexistence of all three options — ECPI, substitute checks and ACH — provides for the optimal clearing of items based on available channels and associated value propositions.

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Check 21 Status

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Expectations on October 27, 2004

- A. No immediate impact for the next 6 to 12 months
 - Deposits
 - Check processing
 - Float reductions
 - Issues
 - No IRD's/Substitute Checks
- B. Legislation described Check 21 operations, not available for at least one to three years
- C. Financial Institutions would provide guidance and lead the way in to the Check 21 era

Local Government Activities During this Time

- A. Discussed Check 21 status with Financial Institutions
- B. Reviewed Financial Institutions' Check 21 Pricing and Processing
- C. Evaluated equipment needs
- D. Educated applicable local government policy makers and departments

Status as of May 19, 2005

- A. Minimal Check 21 transaction impact
- B. No difference in check depositing
- C. Financial institutions working on process and standards

Future Expectations

- A. Check IRD/Substitute Check exchange
- B. Reduced float
- C. Lower costs
- D. Expedited processing