



White Paper

Compelling Reasons to do Image Exchange, Now

Revised January 2008

September 2006

Property of The Clearing House Payments Company L.L.C.

Contents

<u>Section</u>	<u>Page</u>
1. Acknowledgements	1
2. Executive Summary	2
3. Introduction	3
4. Rising Cost of Paper Processing	5
5. Transportation	7
6. Reductions in Check Float	8
7. Value Drivers: Product, Customer, Competition	10
8. Implications of Not Participating in Image Exchange	11
9. Do It NOW	12
10. There is Only One Logical Conclusion	13
11. Appendices:	
a. Resources	14
b. Analysis from a Large Financial Institution	15
c. Why are banks waiting?	17

Acknowledgements

This paper was sponsored by the SVPCO Rules and Operations Committee and developed by banks participating in its Image Adoption Working Group. The committee includes owners of The Clearing House and participants in image exchange and check services.

BB&T	JPMorgan Chase
Bank of America	KeyBank
The Bank of New York	LaSalle Bank
Bank of Tokyo-Mitsubishi UFJ	M&T Bank
Citibank	National City Bank
Citizens Bank	PNC Bank
Deutsche Bank	UBS AG
Fifth Third Bank	U.S. Bank
First Citizens	Wachovia Bank
HSBC	Wells Fargo Bank
Astoria Federal Bank	Harris Trust and Savings Bank
Bank of the West	Northern Trust
TD Banknorth	Washington Mutual Bank
Cole Taylor Bank	Zions Bank

Recognition is due all those quoted in this paper and to the consultants whose graphs and charts are included, and in particular the statements derived from the ECCHO/Federal Reserve video, "Checkpoint: Industry Perspectives on Check Image Exchange," ©2005.

“The participants in the SVPCO Image Payments Network feel strongly that the entire industry is on the verge of accepting image exchange of check images. Image exchange not only results in improved processes, but also leverages the existing image investment at those institutions. Each day, we come closer to our reengineered view of payments processing,” -- Luke Huys, SVP, Wachovia Bank, and Chair of the SVPCO Rules and Operations Committee.

Note: Originally published September 2006. Industry statistics updated January 2008 with November 2007 data.

Executive Summary

Check volume in the U.S. is declining. A more effective way of processing the remaining paper checks is being undertaken by financial institutions. The participation of all financial institutions in the exchange of check images for clearing will benefit all.

Whether with a business case justification in hand, a strategic imperative from management, competitive pressure from customers and other financial institutions, or simply to reduce the receipt of Image Replacement Documents, the image exchange solutions (software, processes, providers, etc.) are now readily available. Image exchange is successful for financial institutions of all sizes, and they encourage every financial institution to join them in the benefits accrued from electronic processing of check images.

This document discusses the reasons for beginning image exchange immediately. While data on the current benefit value is still minimal because exchange is in its early stages, all the participating financial institutions claim noticeable benefits even only a year or two into their image exchange programs. And, while each financial institution is significantly different, they still agree on the list of potential benefits, even without the presence of disclosable benefit analyses. Without embarking on image exchange, an institution denies itself these benefits and may find the playing field no longer level, but instead, slipping out from under them.

The benefit potential for image exchange is clear and considerable. By delaying adoption, the opportunity cost of not participating increases each day.

Introduction

Image Exchange; now is the time to do it. Not too early and not too late.

Participants in the SVPCO Image Payments Network compiled this paper to help in their ongoing efforts to persuade those financial institutions in the U.S. who are not yet sending or receiving image cash letters to begin doing so for clearing their paper checks.

With no end in sight for the use of the paper check as a payment instrument of choice in spite of declining volumes of payments initiated by checks, financial institutions must downsize their conventional check-processing infrastructure. Truncating the check as early in the payment process is the lynchpin to more efficiently processing checks.

Participation in image exchange has now penetrated the industry to the point where the early adopters have paved the way with new technology, rules, standards, processes, and providers and they have primed the pump with growing volumes.

Whether an institution has traditionally truncated or safekept paid checks, like the nation's credit unions, or has used the drive toward electronic payments to reengineer the many systems and processes at a large commercial bank, they are already reaping the benefits of image processing and avoiding the increasing unit cost and difficulties of manual check handling.

Check truncation with image exchange is inevitable. All financial institutions must act now to control their role and manage their own destiny as the new model of check processing sweeps the country.

Why do you need to begin doing Image Exchange, NOW?

- Paper check processing and clearing costs are increasing, while electronic and image processing costs decrease.
- Float reduction is beneficial and optimized by Image Exchange.
- Today's check transportation alternatives will decrease in quality and quantity and increase in cost.
- Value drivers in financial institutions are focusing on new product opportunities, enhanced customer satisfaction, and shifting revenues.
- Image Exchange is critical to staying competitive and successful.

By delaying adoption, the opportunity cost of not participating increases each day.

David Walker, President and CEO, Electronic Check Clearing House (ECCHO) explains, “The question about image exchange has been whether the investment can be avoided or at least postponed. With nearly 50% of all U.S. institutions already receiving check images, it is clear that to be competitive and cost efficient every institution must implement check image exchange products and services. Unless the cost of implementing check image exchange can be expected to decline significantly in the near future, it is also clear that delaying implementation diminishes every institution’s ability to compete. The economics are clear, the longer institutions delay, the greater the cost of missed opportunities.”

Key Messages (November 2007):

- ✓ *Paper checks are being transitioned to electronic images of checks at a pace that is unprecedented. Check images are currently collected in two forms, as substitute checks and as check images.*
- ✓ *Substitute checks assist in evolving traditional paper check clearing to image-based clearing. As a precursor to full check image exchange, the number of substitute checks is a positive indication of the acceptance of image exchange.*
- ✓ *More than 12.3 billion annual check payments totaling \$15.1 trillion per year have already moved from the traditional paper-based clearing process to improved image-based processes.*
- ✓ *On an average day during November 2007, more than 8,200 institutions received almost 36 million check images for posting. These total 9.0 billion checks per year.*
- ✓ *This CheckImage Collaborative image clearing report reflects transactions settled through the Federal Reserve, PaymentsNation (formerly NCHA), SVPCO and local / regional exchanges. When the same payments were cleared through two or more of these organizations, those payments were counted only once.*
- ✓ *The 2007 Federal Reserve’s Payments Study shows that the volume of checks (both written and paid) continue to be larger than debit card, credit card or ACH transactions. The report also shows that the dollar amount of checks increased from 2003 to 2006 from \$40 to \$41.7 trillion.*

“The full promise of check electronification can only be reached when the majority of U.S. financial institutions embrace image exchange of check images while continuing to drive payments and their processing to electronic alternatives,” states Jeff Neubert, President and CEO of The Clearing House. “With the SVPCO Image Payments Network, participants are beginning to realize their vision for full check truncation, as early in the payments process as possible.”

Rising Cost of Paper Processing

Paper check processing and clearing costs are increasing.

The Federal Reserve is increasing prices for paper check clearing products by an average of 5-6% per year.

Expenses for full time employees in a paper item processing environment are continuing to grow with annual salary increases and the escalating costs of benefits.

Occupancy and miscellaneous expenses for supplies and equipment continue to rise.

The cost of moving paper with traditional air and ground transportation increases unit costs as paper check volumes decline and fuel costs increase.

Electronic and image process costs are easing.

The Federal Reserve has continued to reduce the per item price for image related products.

Some components of image processing expenses are on the decline.

Institutions engaged in image processing are finding more significant productivity improvements with image than originally anticipated and vendors are actively working on enhancements for both process efficiency and cost control.

Direct presentments can be made to non-local banks via image that would be cost prohibitive when the movement of physical paper is required.

The Federal Reserve reports:

The legacy forward collection price increase for 2006 was 4.8%

The Check 21 FedForward price reduction for 2006 was 12%, but that combines discounts, FedReceipt shifts, and a pattern of earlier deposits. None-the-less, it is significant.

Terrence J. Roth, Vice President, Federal Reserve Bank of Cleveland, notes that "Given the general declines in legacy paper volumes and the scale economies associated with FedForward Image Cash Letters, we would speculate that over the next few years, paper prices will continue to increase and C21 prices will likely decline."

In the private sector, regional paper clearinghouses will also experience rising costs for clearing paper checks. As more of the large participants in those local arrangements move to image-based clearing, the removal of their volume from the local paper clearing leaves the same overall cost, borne by fewer institutions with significantly less volume, resulting in exorbitant unit costs.

Over the next several years we will continue to see the trend of paper processing expenses increasing while electronics decrease. The image business case should NOT be based on the current costs associated with the processing of paper checks and electronics or images, but on the projected environment.

While fewer paper items move through the system, clearing fees will continue to rise. Every component of the cost of processing the physical check rises, thus stimulating more movement into image exchange.

If the immediate savings on transportation and float don't justify image exchange, the ability to downsize conventional check processing infrastructure does.

Any investment in check image processing will pay off because the check will still be around for a long time to come. Analysts agree that within five years the majority of transit items will be electronically cleared and settled, and that check volume will still be significant.

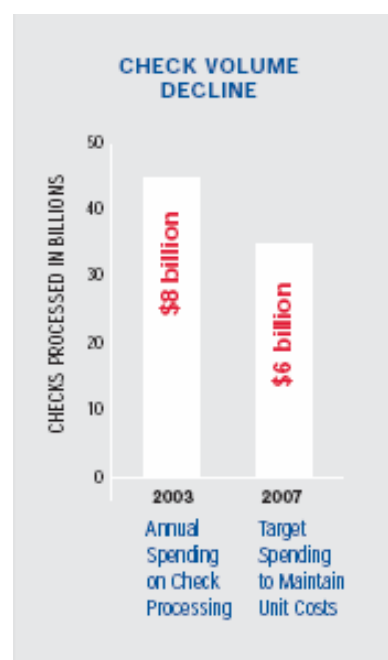


Chart Source: Viewpointe Archive Services
What banks should know about Check 21. 2003

And, the legacy paper handling platforms will quickly become the exception platforms, leading to even higher unit costs and limited, costly, or non-existent vendor and system support, potentially leading to an inability to continue servicing existing products that are dependent on these.

Transportation

Infrastructure that supports the paper environment is destined to disappear.

- Transportation alternatives that exist in today's environment will likely not be available in the near future.
- The Federal Reserve and private carriers recognize the inevitable downsizing of transportation networks.
- Cost will increase.
- Transportation choices will be limited and have lower reliability, dependability, and quality performance. The remaining transportation available will likely be expensive, inflexible, and not offer the accelerated availability that the priority services offer today.

"The biggest cost specter over banks sticking with paper check processing is in air transportation. As top tier banks pull volume out of the transportation network over the next 12 to 18 months, costs will rise sharply. Red flags have already been raised," says Alenka Grealish of the report, *Check Image Exchange: Roads to Rome*, and manager of the banking group at Celent. "Regardless of how a bank is processing checks today, it will end up clearing and settling the majority of its checks via image exchange/share. By 2010, nearly 90% of transit items will be electronically cleared and settled," she adds.

This shift away from ground and air transportation is already impacting the check clearing cost structure. The paper check transportation dynamic is that a small volume of large dollar items paid for the bulk of transportation. These items have already been displaced and are being cleared by images converted to Substitute Checks.

Reductions in Check Float

Image processing is the most significant event in check clearing since the development of the MICR line.

- Image exchange provides an opportunity to reduce check float not available through paper clearing.
- While banks can pay other institutions to image their checks, the expense per item makes this strategy expensive to all but the smallest processors of checks.
- In addition, checks cleared through the FRB in paper-to-image and other substitute checks products generally clear only the largest dollar value items.
- Only through direct image exchange are all items cleared efficiently and at low per item costs.
- This process maximizes the reduction of float across the board and reduces risk through fraud by accelerating the clearing of all checks.

Reducing check float brings significant benefits. A collecting bank's float cost reduction for two-day items shifting to one-day clearing can be estimated. For example, at a 5% interest rate, the float saving is about 2 cents for a \$100 check. For a \$1 million check, it's \$200.

One of the top ten banks in the country cites that for their bank, 67% of their items are less than \$250 and 75% are less than \$500. They estimate a 3-5% float benefit for those converted to image cash letters.

Cheryl Yavornitzki, Vice President, Fidelity Bank, notes that her institution "began sending images via FedForward in October 2005 and achieved 90.7% immediate availability and eliminated the explicit float charge." She adds, "We also eliminated air courier to Kansas City and Oklahoma City."

Value Drivers: Product, Customer, Competition

Once fully implemented, image exchange will support many new and existing lines of business, products, and services such as positive pay service improvements, international cash letter processing, image cash letter deposits, etc. And, it will hasten the movement of paper to electronic payment processing. It is also the intent of this effort to transform the transaction process to provide overall, long term operating expense reduction and customer service/product improvement. As Barbara Desoer, Global Technology, Service and Fulfillment Executive, Bank of America, summarizes “Just as important [as financial benefits] is improving the customer experience.”

“These services improve the diversity of our product offering and provide us with a greater opportunity, we believe, to general service revenue, and importantly, allow us to strategically position our business for long-term processing of checks,” according to Austin Adams, Chief Information Officer, JPMorgan Chase.

Image exchange offers opportunities to deliver new products for both consumer and commercial accounts.

- Industry media reports that the image deposit product is the most sought after cash management service developed by banks in many years.
- The ability to actively compete for this business is dependent on image technology to support the product, and image exchange to keep the product competitively priced and profitable.
- Consumers are becoming more aware of on-line products and the efficiencies of image exchange and Check 21.
- Both consumer and commercial accounts will begin to demand more from their financial institution as they gain an understanding of the benefits both the banks and the customer can derive.
- Financial institutions that have embraced image technology will find themselves in a strong competitive position for attracting new business, retaining its existing customer base, and controlling costs on the new line of products the marketplace will demand.

“Customers like it,” states David Hayes, President and CEO, Security Bank, continuing, “As a community banker, the technology is enabling us to compete with our large competitors throughout this country.”

An image exchange platform is an enabler. Banks that were early adopters of image exchange are already demonstrating an aggressive drive to differentiate themselves with check image-related products and services. This places late adopters at risk of losing the demand deposit account franchise. Unless a bank is only a retail bank, the small middle market and corporate customers need products with image deposits, image cash letters, and an unlimited range of new deposit products. And, banks that serve downstream financial institutions are being pressured to meet the needs of their customers as well.

Implications of Not Participating in Image Exchange

“No bank should risk being left behind as the evolution unfolds,” according to Louise Roseman, Director, Operations and Payments Systems, Federal Reserve Board of Governors.

Investing in image exchange in a time of check volume decline makes sense even if for cost containment alone. And, not adopting image exchange is an opportunity loss. While the benefits derived from image processing for the reduction of operating expense, float and risk are substantial; the cost of not developing image processing capability may be an even more critical issue to consider. Products that can be delivered only through image capture are of greater interest to the customer base for which all banks are competing. Image on demand, on-line images, improved availability and the ability to make remote deposits, are all products the retail and wholesale customer may expect from their financial institution. Certainly the ability to compete for new business is significantly enhanced by an institution’s ability to successfully acquire customers. However, equally important is the risk of eroding the existing customer base. Discussions amongst bankers reflect that depending on the type of depositing product, the existing customer base is at risk. For availability-sensitive products like correspondent cash letters and wholesale lockbox, the customer base might decline by anywhere from a minimum of 10% to as much as 90%.

And, what savings are non-participating institutions forfeiting, and for how long? Michael Argento, Senior Consultant, Global Concepts Inc notes that his firm “estimates that the potential net saving from image exchange is as much as . . . 65% of current costs. Paying banks’ net saving is also quite substantial, up to . . . 55% of their current costs.”

And, how long before the late entrants suffer from their inability to gain benefits? “Checks processed electronically can be converted (truncated) immediately on acceptance and, in many cases, a paper item is not created. You remove the physical check from your payment process at the first step. The need for employees to handle the check is eliminated. This approach increases productivity right away. Compare the electronic process, where the check is handled once, by one employee, to the manual process, which entails 6 to 7 separate steps in which the checks are handled, and the information can be entered many times. The productivity gain is substantial,” concludes Michael Rees, AAP, eCheck2000.

Do It NOW

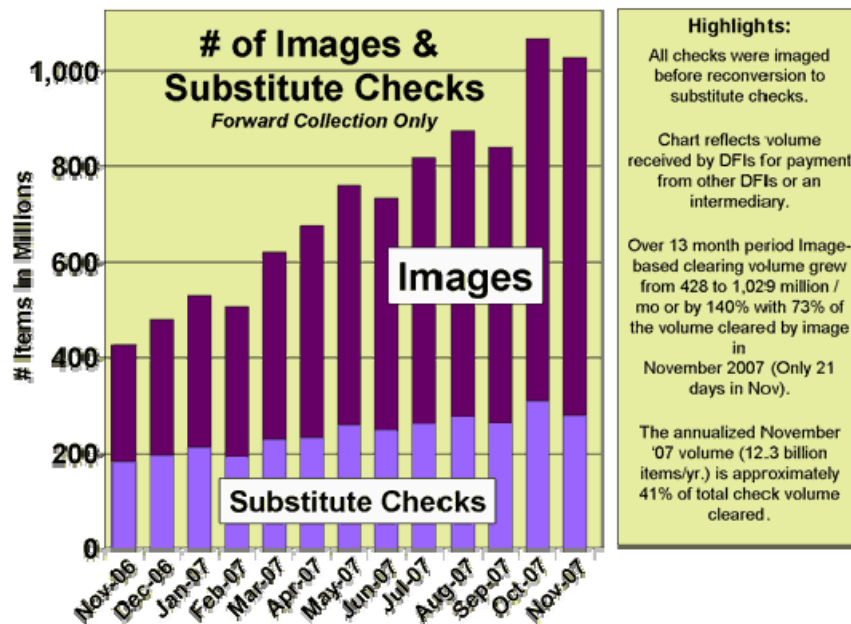
“It all comes down to cost. It’s time. We know it’s there. We know it works.” - Robert Steen, Chief Executive Officer, Bridge Community Bank.

The industry now has many organizations of all sizes in production or on the cusp of active participation in image exchange, with significant volumes. The opportunity to gain the substantial benefits from large volume image exchange has arrived. Implementation of an image platform requires time regardless of the resources assigned to the task. Banks not prepared to initiate the project in the near term will find they have not only missed an opportunity but run a significant risk of lost market share and an erosion of existing customer base.

Those institutions that do not choose to move forward aggressively in the short term may find they face losses in their customer base to institutions that have taken advantage of the opportunities offered through image exchange, and have brought to market image related products sought by their clients. Lost business will be tough to recover.

The wait and see approach has passed. Institutions are already clearing millions of items and billions of dollars via image exchange each day. The process, while still evolving to some degree, is proven and stable.

“Adopting . . . early in its lifecycle . . . produced significant float savings . . . positioned us for investment in the next stage of check-related enhancements. . . . Staying current and competitive.” - Webb Edwards, former Executive Vice President, Wells Fargo and Co.



Source: Transactions settled through the Federal Reserve, NCHA, SVPCO, and local/regional exchanges with no duplicate counting.

There Is Only One Logical Conclusion

Checks will continue to be an important part of the payments system for a very long time.

Recent changes in the law and technology enable a more efficient check payment system.

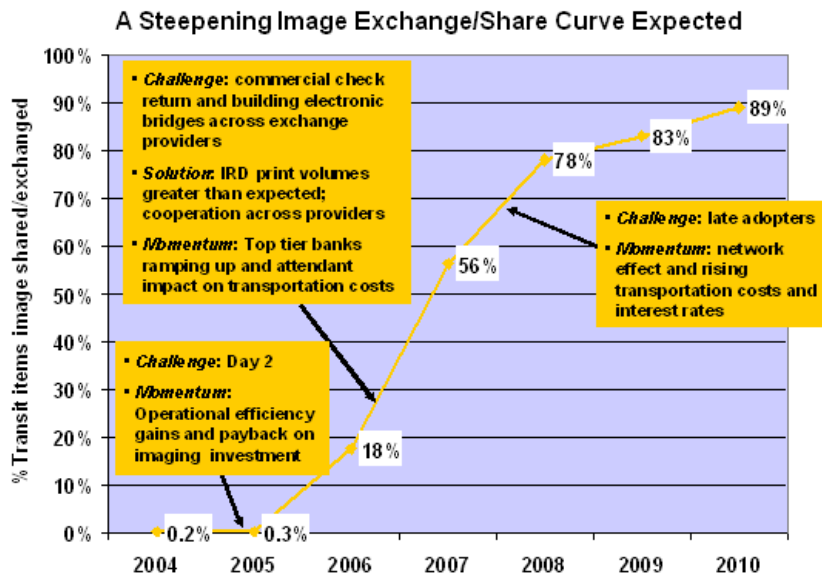
The sooner financial institutions declare their active participation in the changing payments arena, the more quickly they take advantage of this opportunity; the sooner they can share in its benefits.

Earlier implementation is better and of more value than later implementation.

The U.S. banking system's value to those it serves is strengthened by the migration to electronic payments and processing checks electronically. All participants - from the consumer to the financial institutions - benefit from this evolution.

Industry analysts concur that by the end of this decade, few checks will be cleared end-to-end as paper. Global Concepts estimates only 38% by 2009; Celent notes 10% of transit volume by 2010. All agree that in the near future, image exchange will be the most prevalent method of clearing transit checks between financial institutions.

Check truncation with image exchange is inevitable. All financial institutions must act now to control their role and manage their own destiny as the new model of check processing sweeps the country and transforms the way payments are cleared.



Appendix A

Resources

For additional information and support, the following sites, as well as many others, have grown rich with valuable information and tools:

www.eccho.org

www.svpcoco.com

www.frbsservices.org

www.checkimagecentral.org

Appendix B

Analysis from a Large Financial Institution

Once fully implemented, image exchange will support many new and existing lines of business products & services (i.e., positive pay service improvements, international cash letter processing, image cash letter deposits, etc.) and hasten the movement of paper to electronic payment processing. It is also the intent of this effort to transform the transaction process to provide 1) overall, long term operating expense reduction and 2) customer service/product improvement. The table below identifies where some of the process savings can be seen.

Process Touchpoint	Conventional		Image Exchange: Receive		Image Exchange: Send
	Check Stmt	Image Stmt	Check Stmt	Image Stmt	
Paper Receipt & Prep	√	√			√ / ?
Check Capture & Sort	√	√			√ / ?
Reject Repair	√	√			√ / ?
Difference Reconciliation	√	√			√ / ?
Check Repass Sort for Clearance	√	√			
Cash Letter Processing	√	√			
Stmt Cycle & Exception Check Sort	√	√			
Exception Item Processing	√	√	√	√	
Statement IRD Print	√		√		
Check Retention	√		√		
Statement Rendition Check Sort	√		√		
Statement Check Reject Processing	√		√		
Statement Check Reconciliation	√		√		
Statement Rendition	√	√	√	√	
Total Touchpoints	13	8	7	2	4 / 0

It is the consensus of industry analysts that benefits realized will be in direct proportion to volumes processed - the larger the overall industry participation becomes, the more benefits will be achieved across the board.

Areas of benefits and/or new costs:

Image Exchange - Send

Take Out Savings	Potential Savings Magnitude	Sites Impacted
Clearing Fees	Major	All Local
Transportation	Major	All Local
Cash Letter Dispatch - Labor	Medium	All Local
Capture - Rehandle - Equipment	Medium	All Local
Capture - Rehandle - Labor	Medium	All Local
Reconciliation - Rehandle Labor	Medium	All Local
Reject Repair - Equipment	Minor	All Local
Reject Repair - Labor	Minor	All Local

Add-in Costs	Potential Cost Magnitude	Sites Impacted
IQA - System Software	Medium	Virtual Site
IQA - Labor	Medium	Virtual Site
Reconciliation - Labor	Medium	Virtual Site
Transit Bulk File - Labor	Medium	All Local
Transit Bulk File - Occupancy/Destruction	Medium	All Local

Major Expenses > 500K

Medium Expenses = 50K to 500K

Minor Expenses < 50K

Image Exchange - Receive

Take Out Savings	Potential Savings Magnitude	Sites Impacted
Receipt and Prep - Labor	Medium	All Local
Capture - Prime Equipment	Medium	All Local
Capture - Prime Labor	Medium	All Local
Capture - Secondary Sorting Equipment	Medium	All Local
Capture - Secondary Sorting Labor	Medium	All Local
Reconciliation - Labor	Medium	All Local
Reject Repair - Equipment	Medium	All Local
Reject Repair - Labor	Medium	All Local
Day Two Adjustments - Labor	TBD	Day Two Sites

Add-in Costs	Potential Cost Magnitude	Sites Impacted
IRD Print - Equipment	Major	Site
IRD Print - Labor	Medium	Site
IQA - System Software	Medium	Virtual Site
IQA - Labor	Medium	Virtual Site
Reject Repair - Labor	Medium	Virtual Site
Reconciliation - Labor	Medium	Virtual Site

Major Expenses > 500K

Medium Expenses = 50K to 500K

Minor Expenses < 50K

Appendix C

Why are banks waiting?

OR, the reasoning that leads to lost opportunities

1. Wait and see
2. Want / need turnkey solution . . . Want plug and play
3. Resources / priorities
4. Concerned that giving DDA access depletes balances
 - o No geographic
 - o No time limits
 - o E.g., large paying bank (no collection offset)
 - o Change of posting (drain balances earlier)
5. No mandate
6. No "holistic" cohesive view
7. Political factioning - opposing agendas
8. No payment strategy
9. Mainly a local exchange player
10. Fence sitter reasons:
 - a) Wait and see or try to avoid
 - b) Waiting for image on demand
 - c) Waiting until they have to
 - d) Plan to just use ACH conversion products
 - e) Heard there might be image exchange via ACH with image on demand
11. They are dissuaded by the "urban myths" of image:
 - a) Quality
 - b) Customer acceptance
 - c) Original check is still required for proof
 - d) Electronic fraud from image