



MERKLE

Response Management Group

***Empowering Knowledge to
Improve Financial Results***



Image Cash Letter

vs.

Account Receivable Conversion

Least cost routing

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Merkle Response Management
Services

Objective and Agenda

- Paper processing
- What is 'least cost routing' ?
- Cost benefit analysis
- What does it mean?
- Take away

Check Processing History

< 1985

- Checks sorted by end point
 - Local Banks
 - Local Clearing Houses
 - Federal Reserve
 - Direct Exchange – Cash Letter
- Early ACH: 1972 in California between regional fed and local banks. Grew to nationwide (NACHA) in the 80's with the passage of the Monetary Control Act. Expanded to what we know today – PAYROLL.

Manual processing of paper!

Check Processing History

- 1990
 - Fed Payor Services
 - Federal Reserve Clearing
 - Electronic Check Presentment
 - Electronic file precedes paper check
 - Check required for settlement

Float reduction, but still paper dependent!

Check Processing History

- 2000 and beyond
 - ACH Check Conversion
 - BOC
 - ARC
 - POP
 - Check 21
 - Image equivalent to paper
 - File exchange for settlement

Convert paper at point of insertion!

Electronic Check Conversion

- ACH Check Classifications
 - BOC: Back office conversion
 - Submit checks to ACH network after POS
 - ARC: Account Receivable Conversion
 - Checks received by mail
 - Consumer checks predominate
 - POP: Point of Purchase
 - Conversion at point of sales as source
 - Return paper check with receipt

Convert paper at point of insertion!

Check 21 ACT of 2004

- **Legal Equivalence**
 - IRD carries same legal protections as paper check
 - IRD clears along same workflow chain as paper check
 - IRD = Substitute Check if confirms to Check 21 requirements.
- **Volunteer**
 - Banks can truncate paper at any step along check clearing path
 - Banks can create substitute checks (IRD) for processing at any step along check clearing path
 - Banks ARE NOT required to accept electronic image, but must accept substitute check (IRD)
- **Multi Lateral agreements enforceable between banks and clearing houses**
- **ANSI standard file format (X.937) created to process substitute or (IRD) files within industry acceptable format**

Electronic Check Conversion

- ACH Check
 - NACHA regulations and REG E application for consumer checks
 - Checks under \$25,000
 - “Third Party Checks”
 - ‘Auxiliary on-us-field’
 - Mutual Fund or Credit Card checks
 - Check is source document for ACH origination
 - Check returned to Payee

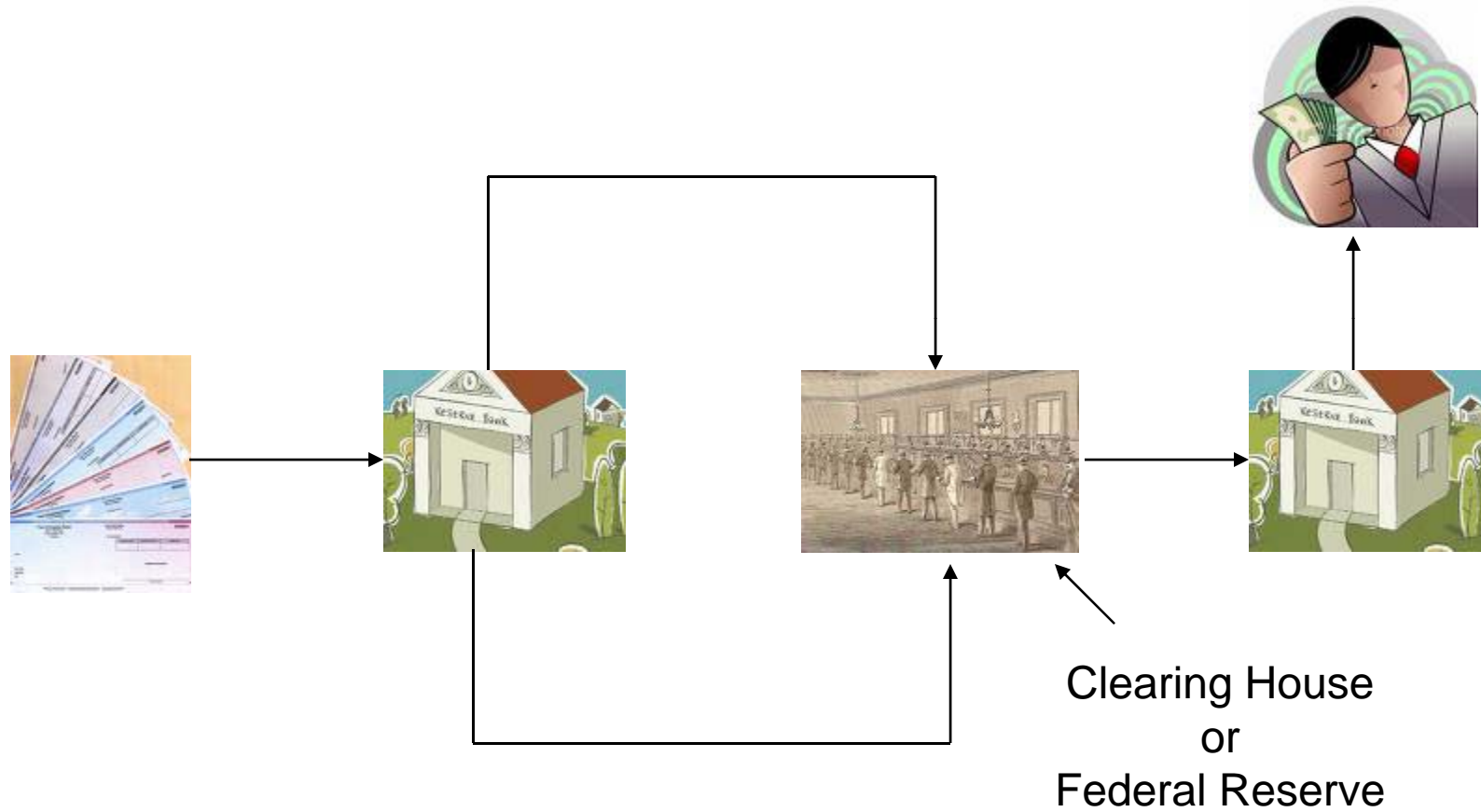
Convert paper at point of insertion!

Least Cost Routing

- **Payee's View Point**
 - Optimal clearing channel/s for paper check transaction
 - Choice of ACH, Check 21, Paper or combination
 - Availability contrasted with costs and regulations

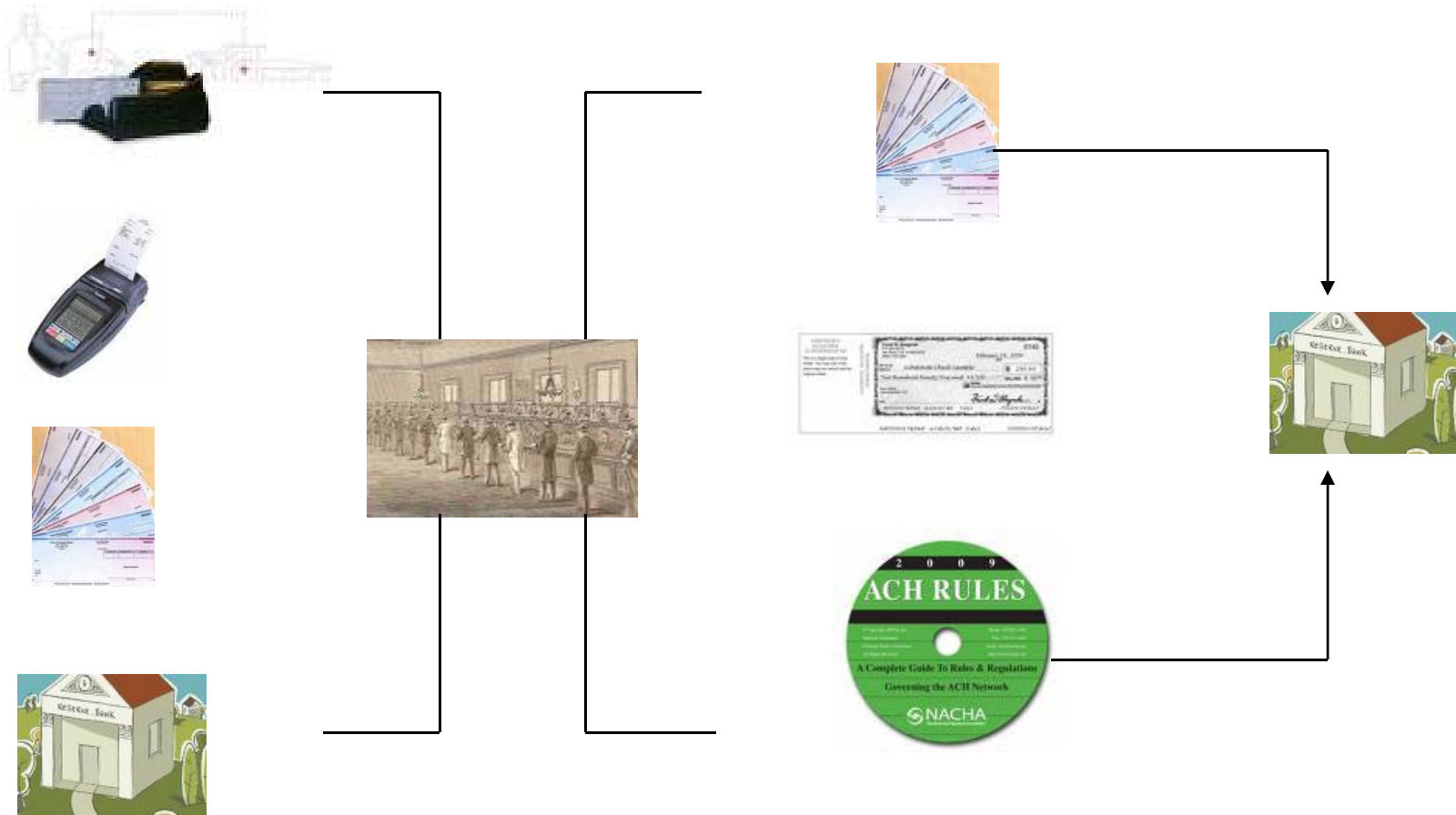
- **Payer's View Point**
 - Lowest transaction cost
 - Reduced availability

Transaction Routing

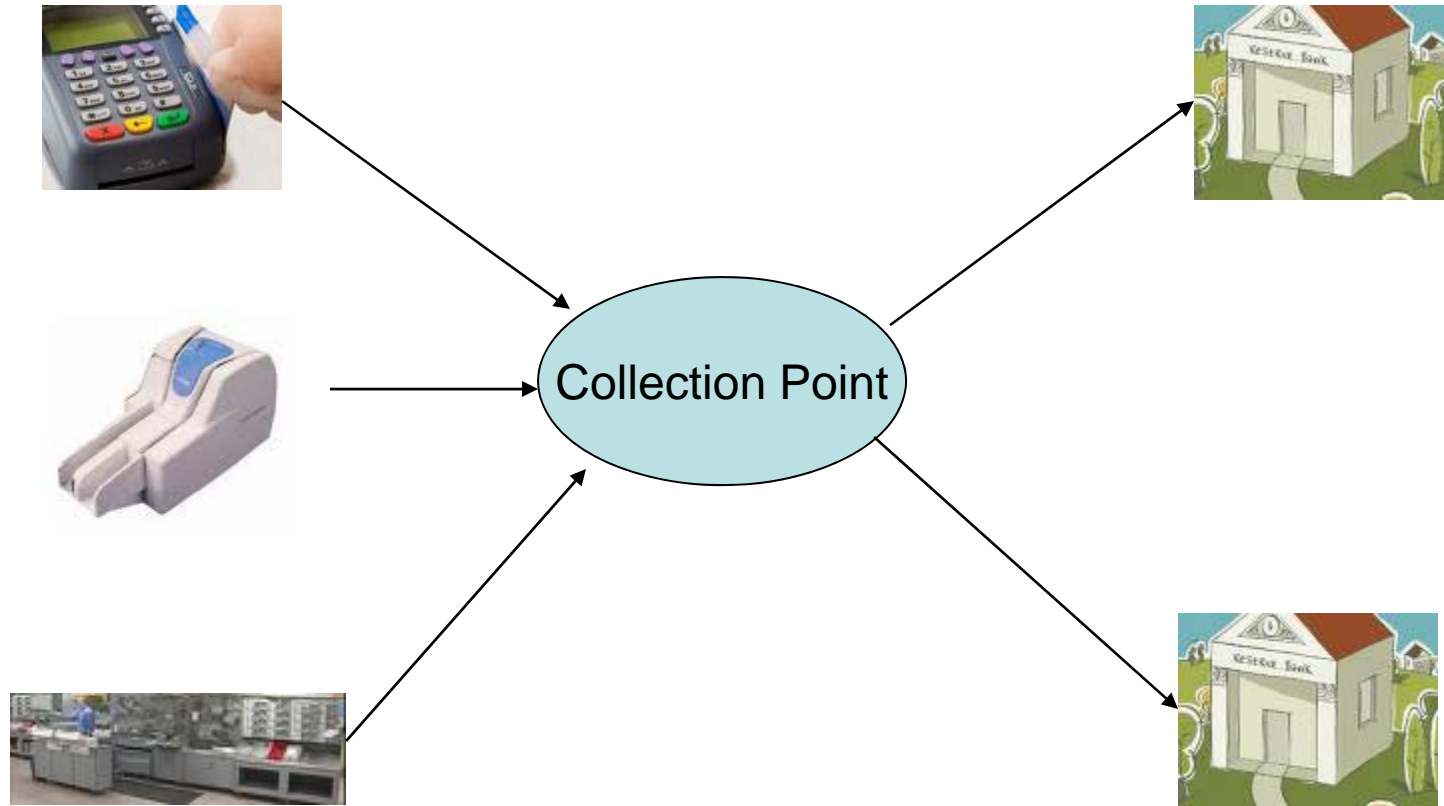


Transaction Routing

ROUTING DECISIONING



Third Party Remote Deposit



Transaction Depositing Channels

- **Remote Check Deposit**
 - Desktop/Office based
 - Remote deployment
 - Low volume
- **Bank Branch Deposit**
 - Routing decided by bank
 - Increased float
 - Delivery restrictions
- **Lockbox Deposit**
 - Image conversion prior to bank deposit
 - Data capture along with transaction processing
 - Float reducing

Transaction Routing

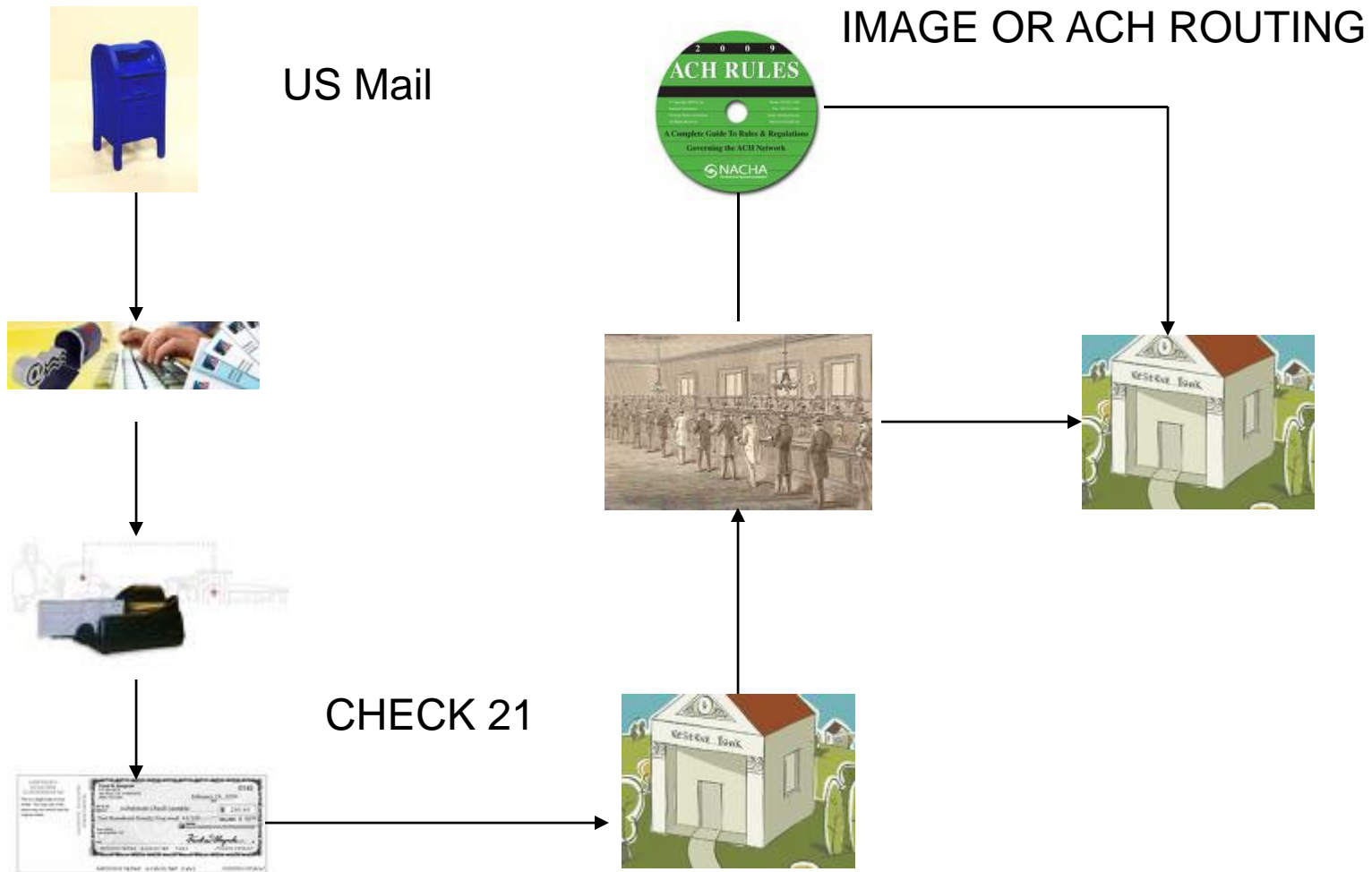


Image Delivery

- **Image Cash Letter**
 - Convert checks to (x.937) file
 - File transmittal to bank of 1st deposit
 - Equipment intensive
- **Remote Desktop Scanner**
 - Low volume
 - Web based
 - Check conversion only
- **Lockbox Deposit**
 - Image conversion prior to bank deposit
 - Data capture along with transaction processing
 - Float reducing

Regulatory Considerations

- Check 21 creates warranty of accuracy and indemnification for Substitute Check
 - Protection against duplicate presentment
 - Substitute Check (IRD) complies with legal requirements
 - Indemnification against loss incurred by recipient of Substitute Check of loss due to clearing of Substitute Check
- Downstream issues
 - Warranties passed to Image Creator and / or Corporate depositor through Image Service contract
 - Check storage until image processing complete
 - Check destruction

Regulatory Considerations

- ACH Check Conversion
 - NACHA regulations and Reg. E govern ACH
 - 60 Day window for Consumer/Unauthorized returns
 - Disclosure and authorization requirements
 - Liability transfer from Paying Bank (RDFI) to ACH Originating Bank (ODFI)
 - Compliance on ACH rules around 'auxiliary on-us field' or > \$25,000 amount etc.
- Downstream issues
 - Originator must obtain, maintain and provide verification of disclosure for ACH conversion
 - Opt-Out provision and file maintenance
 - Conversion processor vs. Corporate originator

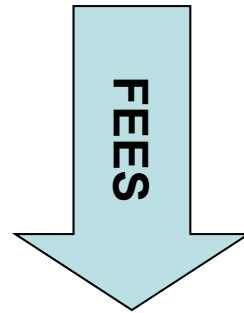
Conversion Regulatory Considerations

- **ARC (Account Receivable Conversion)**
 - Payor Opt-Out
 - Language and proper written notification of conversion
- **BOC (Back Office Conversion)**
 - Posted language of conversion at Point of Sale
 - Consumer signs check
 - Notice language provided with consumer protections
- **Check 21 Truncation**
 - No notification/language required to consumer

Cost Benefit Analysis

Fees ~ current

- Check clearing
- Image
- ACH debit



Fees ~ future

- Check clearing
- ACH debit
- Image

Float

- ACH = +/- 48 hours
- Image = 0 day ~ 1 day (*Watch for premium pricing!*)
- Substitute Check = 1 ~ 3 days

Cost Benefit Components

Transportation

- Desk Float
- Courier Fees

Efficiency of Business Process

- Eliminate encoding errors
- Reduce deposit preparation
- Later credit window for same day availability

Regulatory

- Notification/language required to consumer

ACH and ICL Cost Benefit Components

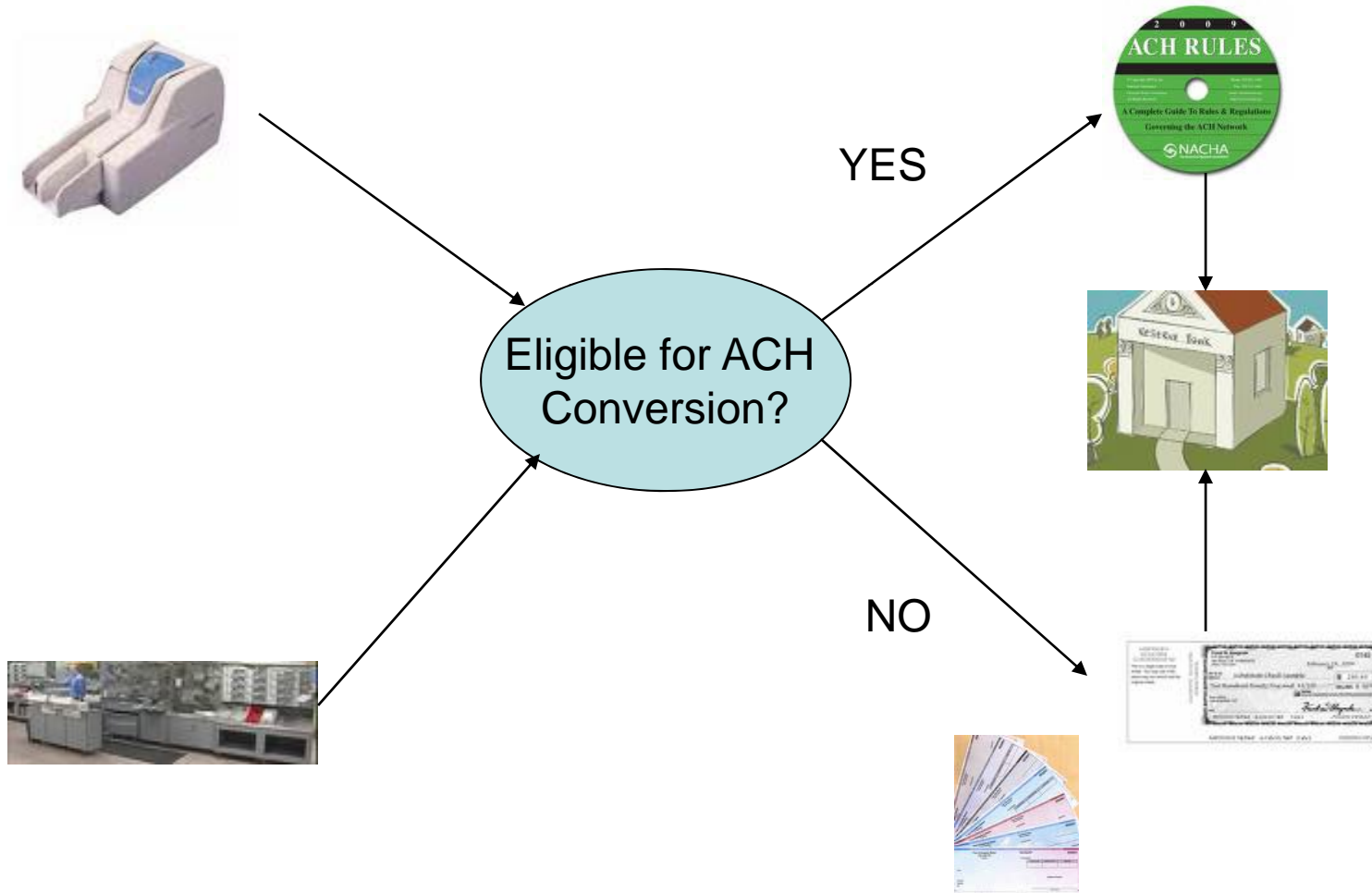
ACH

- Return notification
- 2 additional presentments
- Timing of representment
- Consumer protection
- Regulatory notification
- Opt-Out

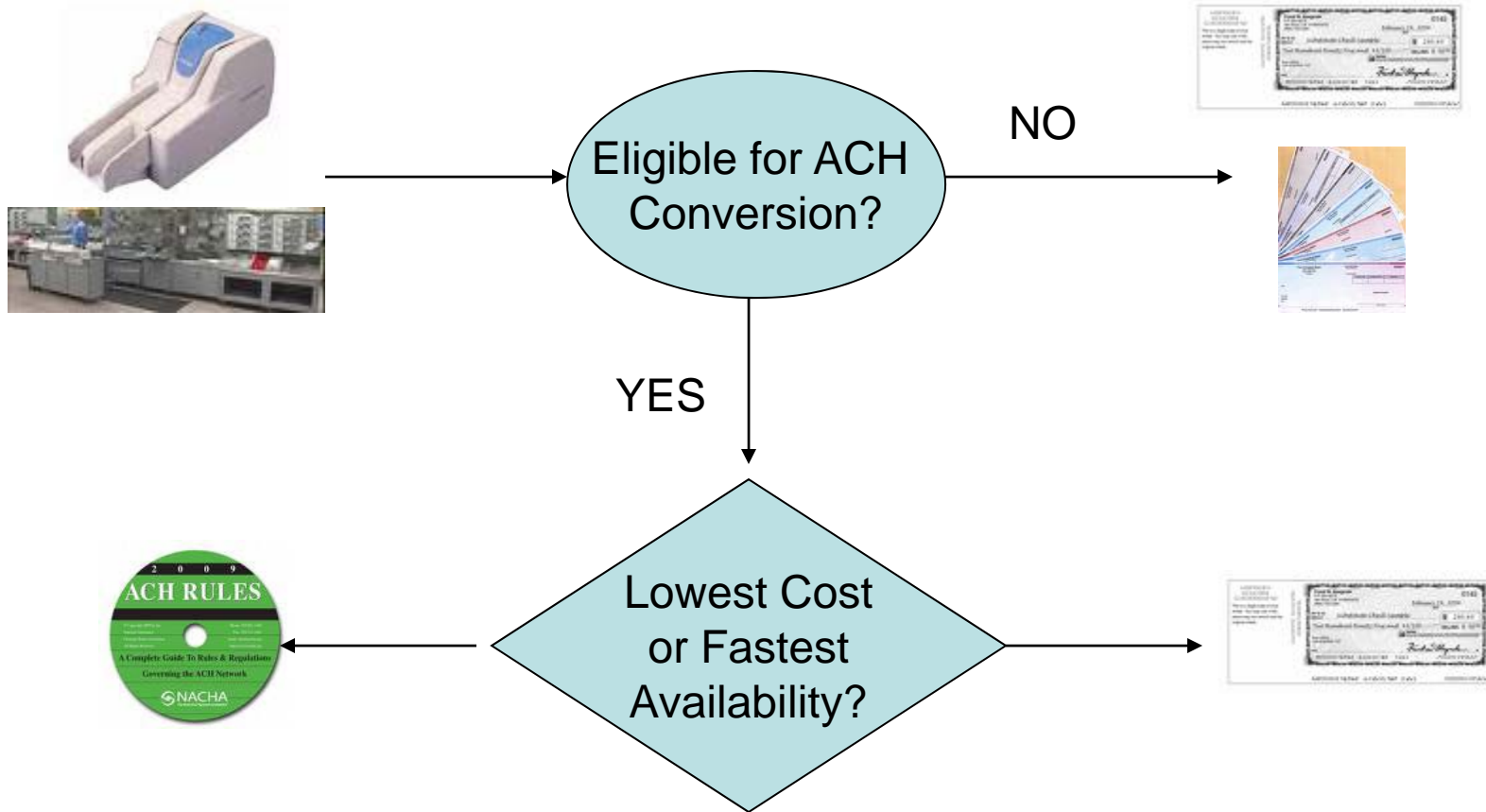
ICL (CHECK 21)

- Same day availability
- Lowest potential clearing cost

Current Routing Model



Future Routing Model



Decision Model

	\$100/Deposit	
	ACH	ICL
Clearing Fee	\$.05	\$.25
Days Float	1	0
COF @ 5%	\$0.014	\$0.00
TOTAL COST	\$.0614	\$.25
Difference	- \$.186	\$.186

Decision Model

	\$5000/Deposit	
	ACH	ICL
Clearing Fee	\$.05	\$.25
Days Float	1	0
COF @ 5%	\$0.685	\$0.00
TOTAL COST	\$.735	\$.25
Difference	\$.485	- \$.485

What does it mean?

Least cost routing benefits both the client and the bank.

It will be instituted regardless of end users request by banks.

Services utilizing “LCR” are starting to become available, but are not fully realized as components or standalone products.

Information is incomplete around identifying optimal clearing channel.

Take Away

Compare clearing options to transaction types.

Engage your bank around clearing services, information available and associated cost reductions.

Negotiate around banks clearing channel and availability.

Be aware of regulatory issues affecting clearing options.

Third-Party vendors may have additional burdens related to introduction of transactions into clearing channel.

THANK YOU FOR YOUR TIME!

Suggested websites:

1. Nacha.org
2. Check21.com
3. ABA.com
4. FDIC.gov
5. ECCHO.org

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