



A Whitepaper on “Check Clearing for the 21st Century Act”: An Analysis of Compliance Investment Costs vs. A Transactional Cost Alternative.

Introduction

The “Check Clearing for the 21st Century Act”, known as “Check 21 Act” or simply “Check 21”, takes effect October 28, 2004, and is one of the most important pieces of legislation to impact the financial services industry in decades. This act will bring monumental change to the check-clearing process, since it provides for the use of electronic check images in the settlement of payments. Check 21 frees banks from having to send paper checks to one another and sets the stage for major changes, including addition of branch-based scanning systems, new data repositories and automated image processing applications.

It is believed, however, that an industry wide rollout of electronic check clearance and settlement technology will likely take years. Furthermore, it is estimated that the cost of deploying imaging applications to handle day-two work alone range from \$4 million to \$6 million for large banks. These costs involve reengineering the back office, investing in image technology for improved efficiency, establishing check image exchange infrastructure, and implementing new ways to optimize electronic check processing systems.

Over the coming months, many financial institutions will begin to struggle with two primary non-revenue generating areas of focus regarding Check 21 compliance: cost reduction and the cost of complying with the new law itself. Cost reduction opportunities are significant, and the potential numbers involved are too big to ignore. Business justifications of solutions supporting such cost reduction efforts include tangible and intangible components. Tangible components of the process that can contribute to cost reduction include:

- Re-engineering of the check-clearing process
- (Further) Automation of check-clearing processes
- Decreasing complexity and process burden
- Increasing reusable process components
- (Further) Reducing manual intervention in check processing systems
- Reducing physical transportation burdens

These components are powerful contributors on cost center impact initiatives. It is estimated that the move toward Check 21 compliance will eventually reduce processing costs industry wide by at least \$2 Billion annually, through re-engineering of check-clearing processes that are comprised of inconsistent and overlapping efforts which cannot be controlled. (Increased) Automation of the re-engineered processes will further leverage reduction. Simply automating inefficient, redundant and incompatible processes will not allow for achieving full cost reduction objectives, however. Reusable process components and reduction in process/application overlap can be used to further leverage the expense side of the equation.

Automation of the processes provides an opportunity to decrease complexity and burden. Empirical metric results, based on categorizations of our check-clearing processes for both consumer and non-consumer checks, indicate provision for a more accurate estimation of ROI/breakeven, and annual annuity saves.



Intangible components include such items as the ability to maintain a competitive edge, minimizing operational risk and maintaining/increasing client goodwill. Other considerations include minimizing liability issues raised by the new law which relate to increased consumer protection and account re-crediting.

While business drivers for cost reduction are an element in the equation, the current regulatory environment provides another area of opportunity. Specifically, due to Check 21, the financial services industry is facing an increasing number of challenges.

Check 21 does not:

- Require the depository bank to create an image of the check. Check imaging is voluntary
- Altering the clearing system. The imaged item will be routed according to the bank of first deposit's preferences.
- Mandate either electronic image exchange, or electronic presentment. The image is sent through the clearing systems, not just the MICR line.
- Turning a paper check into an electronic funds transfer.

As a result, while it a financial institution is not required to implement various alternatives provided by the Act, it could gain a competitive edge in doing so. Yet, in general, the financial services industry has not focused on developing such components in their automated processing environments, and the implementation of such components can involve significant upfront costs.

Enterprise Check Cashflow OptimizationSM

Background

Enterprise Check Cashflow OptimizationSM, or ECCOSM, is an industry-wide offering that positions our clients with an innovative value proposition. ECCOSM will enhance the enterprise cashflow cycle, by optimizing funds availability, and providing Check 21 alternatives today. Challenges, including development, re-engineering, and hard dollar investments, are mitigated by an existing alternative that minimizes Check 21 impacts. At the core of ECCOSM is an interactive and intuitive process that allows for the realization of an immediate tangible reality.

Fundamentals of ECCOSM

A significant appeal of the tremendously powerful tool is its simplicity-virtually any check to cash conversion process can benefit by the use of ECCOSM. ECCOSM is model-based. The ECCOSM Model represents the process to be optimized: ***funds availability***.

Current constraints and cost relationships which impact immediate funds availability are neutralized. Moreover, the technology is fully scalable from the most discrete process to an entire enterprise. In addition, check truncation benefits can be realized today, and Check 21 impacts can be minimized through an alternative that currently exists.



Optimization with ECCOSM

Using this advanced model-based process results in *rapid and effortless* check to cash conversion. ECCOSM focuses on a single, common measure: *Profit*. The inability to integrate models providing instant check to cash conversion across the enterprise creates profit sub-optimization. Furthermore, diverse models are generally esoteric, and therefore, they fail to support an immediate check to cash solution.

Financial Alternatives:

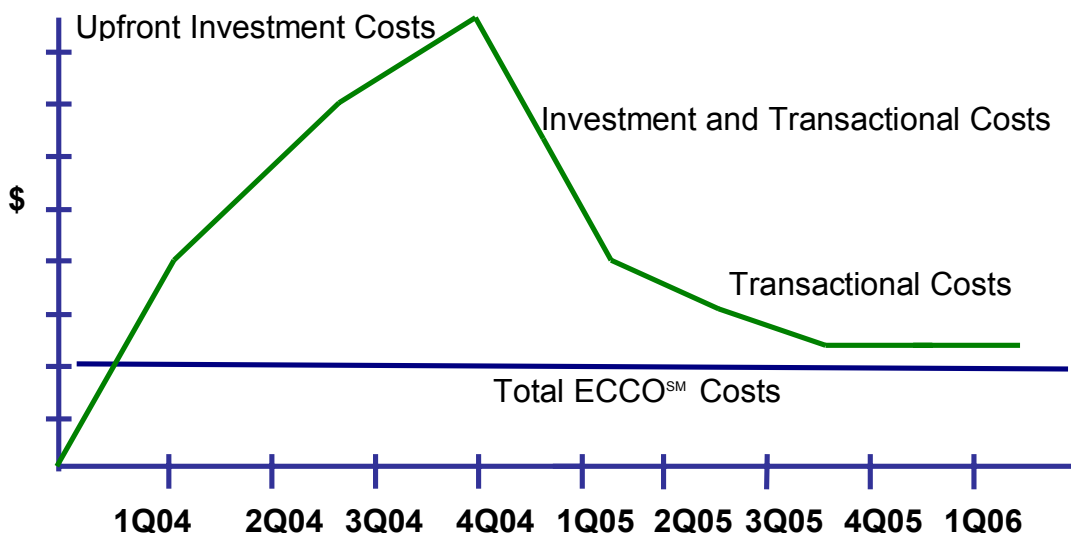
Upfront Investment Costs vs. ECCOSM Implementation

Current conservative dollar estimates indicate the minimum Check 21 conversion levels will reach into the millions. These upfront costs, which need to occur within the current timeframe before October 28, 2004, may impact current budgets from different enterprise segments. Such impacts may collide with other priorities.

In addition to upfront investment costs, financial institutions and enterprises will incur transactional costs associated with the process. These costs cannot be accurately determined, since the infrastructure to support such processes has not been currently defined.

ECCOSM is a viable solution that is currently in use. ECCOSM does *not* require any upfront costs, development effort and/or additional IT investment.

Consider the alternative solutions:





Assuming transactional volumes were constant, the utilization of ECCOSM would mitigate or reduce upfront development, implementation and investment costs.

Conclusion

The ultimate benefit of the ECCOSM model is that it translates your clients' checks into instant cash. Other benefits of CDS' ECCOSM are:

- ✓ Profit becomes the single common measure relative to check processing
- ✓ Enables enhanced funds availability
- ✓ Delivers the optimal profit for a model, the areas of greatest profit opportunity, and Delivers the optimal profit for a model, the areas of greatest profit opportunity, and what they are worth.
- ✓ Rapid implementation
- ✓ Check 21 solution today
- ✓ No upfront development costs

For more information on Enterprise Check Cashflow Optimization please contact:

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