Payment solutions in an electronic era

Opportunities abound today—and more are on the horizon—for treasury managers to increase operational efficiency by leveraging electronic processes and check imaging.

A revolution in payment transaction processing, one aimed at eliminating the traditional dependence on paper checks, is well under way. This transformation already has created the potential for tremendous new treasury efficiencies and cost savings and promises more of the same in the coming months and years. Similar to how robotics re-engineered automobile assembly and transformed that industry, electronic processes and imaging technology are dramatically improving how organizations handle payment transactions and information.

The potential benefits for corporate treasury departments are wide ranging—from spending less money to transport and store paper checks, to more timely access to information about payments that leads to better cash management decisions, to the ability to reallocate staff resources to core business tasks. Faster collections and receivables turnover are also possible.

If you have been to any gathering of industry peers recently, you know there is quite a “buzz” about this revolution. In fact, when emerging payment solutions are the topic, you hear an entirely new and sometimes confusing language, complete with electronic-check conversion acronyms such as “ARC” and “POP” and newfangled terms like “remote image capture.”

Conversion and truncation

To avoid being overwhelmed, it helps to remember that most of these new payment solutions fall into one of two distinct categories: check conversion or check truncation.

Check conversion refers to the five “e-check” services sanctioned by NACHA–The Electronic Payments Association: ARC, POP, WEB, TEL and RCK. These services take a transaction that starts out as a paper check (or checking account information) and convert it into an electronic (Automated Clearing House or ACH) transaction. The goal is to gain efficiencies by delivering the transaction to the bank electronically. Such electronic transactions cost much less than paper ones, can credit faster and reduce some fraud and bad-check risk.

Most of the other new payment solutions fall into the second category, check truncation. Truncation is about eliminating the paper checks and sharing the information and images related to those transactions electronically. The aim is to avoid the time and expense of transporting and storing checks, and gain quick, convenient access to payment information that will aid in cash management decision-making.

The hot new development impacting check truncation is the Check 21 law that goes into effect on October 28, 2004. The law establishes a new negotiable paper document called a “substitute check” that includes an image of the front and back of the original paper check and can be processed in the same manner as the original check. Check 21 makes a substitute check the legal equivalent of the original check and says banks must accept substitute checks from other banks for processing. Because substitute checks can be printed in the
location of the paying bank using an electronically delivered check image, they can eliminate some check transportation costs. The more significant impact of Check 21, however, is that it has opened the door to the electronic interchange of check data and images between banks. “Image exchange,” as this practice is known, is a more efficient form of check truncation because it totally eliminates paper from check processing.

Many banks are responding to Check 21 by building their own image-exchange infrastructures. From a treasury perspective, the exciting development is not that banks can now exchange images. Rather, it’s that from these technology investments should come a new generation of image-based payment solutions.

Solutions you can adopt today

KeyBank product managers in Global Treasury Management (GTM) lately have been asking many of their clients how they use paper in their back offices and where they feel they might be able to add efficiency using electronic solutions. In fact, to better understand our clients’ businesses, we have been conducting surveys and making numerous onsite visits to see first-hand how clients’ treasury back offices function. One reason these client inquiries and visits are so valuable is they often highlight processes that KeyBank can help clients make more efficient today with existing payment solutions.

While all the interest in post-Check 21 payment solutions is justified, it’s notable that KeyBank has offered powerful check imaging and truncation solutions for several years. “We have a wonderful array of solutions that clients can take advantage of right now,” says Robin Cottingham, Senior Vice President and Director of Corporate Product Management. “In most cases, the services we offer today can provide 50% to 60% of the efficiencies that our clients want.”

For example, some organizations still reconcile their checking accounts manually. KeyBank can offer a direct transmission of paid-check data into their general ledgers to automate that process. Users of KeyBank’s Account Reconcilement Plan (ARP) service can also receive a monthly CD-ROM with their checking account statement and check images, enabling them to perform their payments research and reconcilement online.

For organizations tired of the expense and effort associated with storing and retrieving paper checks, KeyBank also offers access to both a short-term image archive (60 days past check paid date) and a long-term image archive (check images for up to the past seven years) through our Key Total Treasury® Internet channel. Clients can use Key Total Treasury (KTT) to retrieve paid-check images on their PCs almost instantly. Check images accessed from a CD-ROM or from KeyBank’s online check archives meet today’s auditing requirements for companies.

“Clients can improve their reconcilement processes, lower check storage costs, shorten check research time and significantly minimize their risk of fraud—just by using some of our current payment solutions,” Cottingham explains.

In addition, clients can utilize ACH services to eliminate paper when processing payroll or paying vendors; Electronic Data Interchange (EDI) services support electronification between trading partners; and the wire transfer of funds for critical same-day payments can eliminate or reduce paper disbursements.

On the collections side of the payment equation, KeyBank offers image-enhanced lockbox services. Through KTT, users can access images of checks the day payments arrive at the lockbox and are deposited, instead of waiting for paper remittance packages to be delivered. Such timely access to information about incoming payments allows clients to post payments faster and make more timely credit management decisions.

Furthermore, KeyBank is in the process of introducing a range of e-check/check conversion services which provide collection options that can reduce float as well as bank fees.
E-check trends and strategies

Growth in check-to-ACH conversion payment volume has been explosive. The best example is accounts receivable conversion (ARC), the electronic conversion of consumer checks mailed to a biller or deposited at a dropbox for payment. The number of ARC e-check payments exceeded 208 million in second quarter 2004, up nearly 800% over the previous year, making ARC the highest-volume e-check type, NACHA reports.

For organizations that collect consumer payments by mail, particularly those with many non-local items, ARC offers potential savings on operational costs and bank fees. Processing an ACH payment costs about one-third what it costs to process a paper check. Additionally, the float savings offered by check-to-ACH conversion is significant and will grow if, as expected, interest rates continue to rise.

KeyBank is installing an ARC solution targeted to larger clients that process 10,000 or more items a month in an automated internal lockbox operation. Strong candidates for this service will be energy and utility companies. On a second front, KeyBank is working with a third-party vendor to introduce an ARC solution for lower-volume clients whose internal lockbox operations today are primarily manual.

Internet-initiated entries (WEB) are the second most popular check conversion service, with NACHA reporting more than 170 million WEB payments in second quarter 2004. KeyBank expects to release its ARC solutions, as well as new solutions for WEB, check conversion at the point of purchase (POP), and re-presented check entries (RCK) by year-end 2004.

Gearing up for image exchange

Check conversion isn’t for everyone, in large part because current NACHA rules don’t allow companies to convert business checks and certain other types of checks into ACH entries. For many organizations, that’s where image exchange could play a role. It will allow banks to accept electronic check images for all types of domestic checks, consumer as well as business checks.

When a critical mass of banks are processing checks using only their images, one clear benefit for bank clients will be more efficient and timely access to payment information. With the need for banks to transport paper checks to one another eliminated, organizations should be able to receive information about their check payments one, or in some cases, two days sooner.

Another clear advantage of image exchange is that it will create a safer, more reliable payment system. When most checks are transported from bank to bank electronically as images, disasters that cripple the transportation networks that carry checks, such as the 9/11 tragedy, are much less likely to bring the payment system to a halt.

With image exchange, the big question is how long it will be before a critical mass of banks have made the technology investments and completed their pilot programs so they are ready to participate. No one can say right now. However, a number of banks, including KeyBank, have started aggressively down the image exchange path.

KeyBank continues to build on its past image technology investments in preparation for Check 21 and image exchange. For some time, all of the bank’s “day 1” back-office processes have been image-enabled, allowing for image capture of every check that comes into the bank. Meanwhile, most “day 2” exception processes (e.g., image retrieval and adjustments) are now image-enabled and all should be by mid-year 2005.

In addition to investing in its own image exchange infrastructure, KeyBank is playing a leading role within the industry to make image exchange happen. KeyBank is one of 20 owner banks and one of only eight “vanguard” banks in SVPCo (Small Value Payments Company), a consortium that’s designing an image exchange network which will act as a check-image clearinghouse to power the initiative. What’s more, this fall KeyBank is partici-
Remote client image capture

Another payment solution on the horizon—a natural extension of image exchange—is remote client image capture. The concept is for bank clients to invest in the necessary hardware and software and capture check images themselves—at their own office or store locations, for example—and deposit those checks remotely by transmitting the check images to the bank instead of the original paper.

Remote client image capture allows organizations to participate directly in cost reductions created by re-engineering the daily deposit process in this way. Costs and staff time associated with physically delivering checks to the bank each day are eliminated. Having images of all incoming checks on hand also can improve check research and customer service processes.

Furthermore, this strategy could enable organizations that have traditionally made end-of-day deposits to meet earlier deposit deadlines. Ultimately, when image exchange takes hold in the banking industry, this could lead to reduced float and improved availability.

Likely candidates for remote image capture are organizations that make over-the-counter deposits at bank branches, in particular ones with high-dollar items they want to deposit faster. This strategy also could be appealing to organizations far from bank branches that find delivering check deposits a challenge.

KeyBank is planning a fourth quarter 2004 pilot to test remote image capture with a number of clients, including a KeyBank affiliate with 87 offices in 15 states. Because geography no longer matters with this strategy, it could allow a regional or national organization that deposits into multiple banks to consolidate its business with one bank, such as KeyBank.

What’s your payments strategy?

In recent years the banking industry has been consistently moving toward electronic payment processes and less dependence on paper checks. It began with check imaging applications and the introduction of electronic check services, and continues today with Check 21 and the unleashing of image exchange and new solutions like remote client image capture. Organizations that embrace these changes can benefit in many ways, as we have reported. But this requires some analysis and ultimately that you develop a payments strategy.

At KeyBank, we can help you establish the proper strategy. We can visit your organization, spend time in your back office, and assess how you initiate and receive payments, either paper or electronic. Furthermore, we can help you determine whether any of the check conversion or check truncation solutions we offer—or some combination of those solutions—should be part of your payments plan.

Here’s an example of how we can help: KeyBank is developing an image statement capability for commercial clients that is expected to be ready in mid-2005. Instead of receiving a hard copy statement with paid checks, organizations that no longer want to store their checks will be able to receive a hard copy statement with miniature copies of their checks, printed front and back on sheets of paper. Based on your monthly check volume and research needs, KeyBank can help you determine if the image statement option makes sense for your organization—or whether another option such as short-term or long-term image archive access might be a better fit.

Many of the future or emerging payment solutions discussed in this report could be right for your organization, and we can help you determine that. By the same token, we have many image-based truncation solutions that could add efficiency to your operations today.

To identify the most efficient set of payment solutions for your organization, start today by contacting your KeyBank Global Treasury Management Sales Officer. We encourage you to share this special report with any colleague who might benefit.