
The New Retail Payment System: Implications for Credit Unions

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April 10, 2006



Agenda

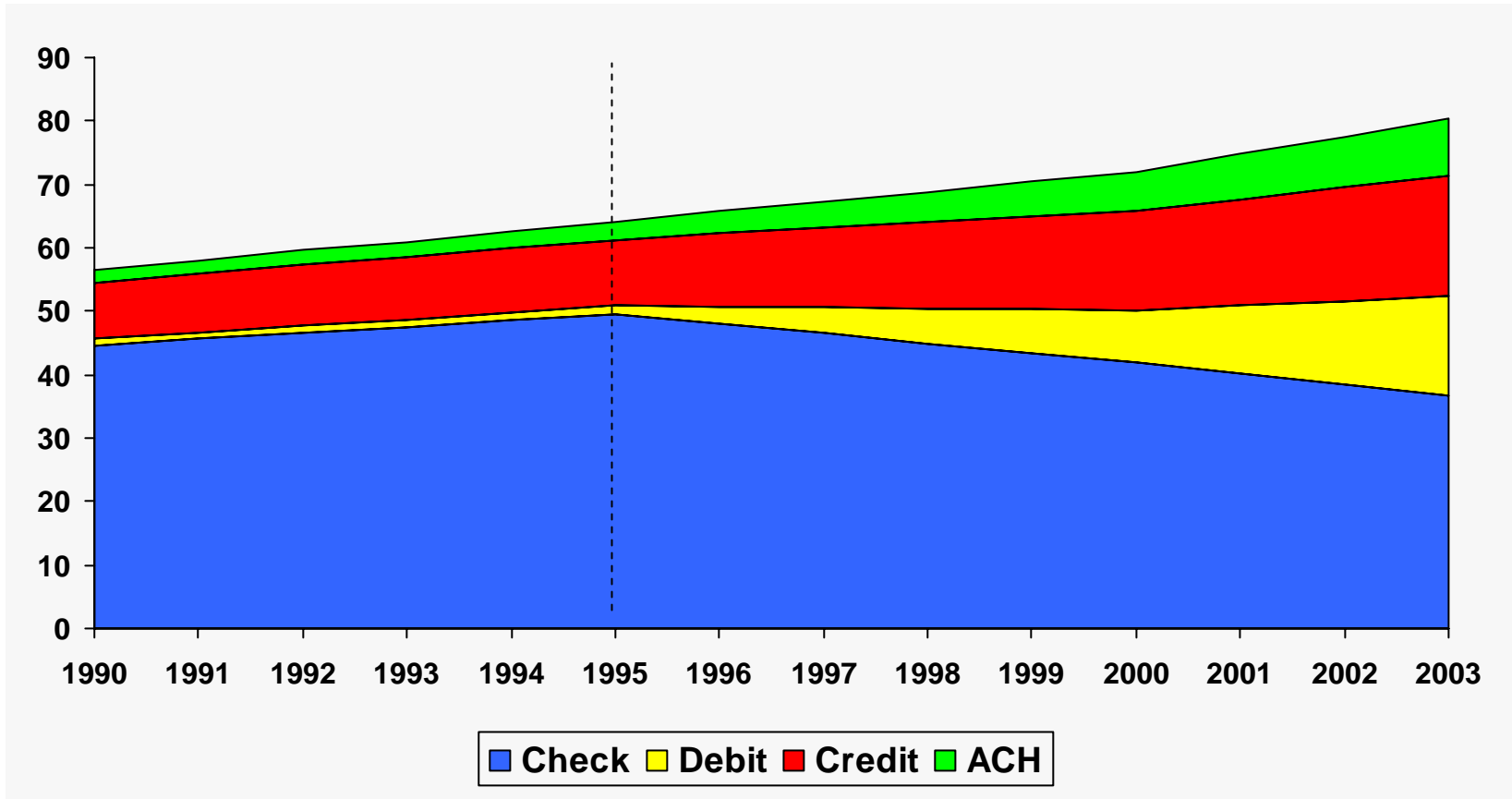
- What are the payment trends?
 - Fed services
 - Retail payments
- How is consumer payment behavior changing?
 - In-store
 - Online
- What do these changes mean for the payments system?
- What are the implications for credit unions?

Volume and Value of Federal Reserve Payment Services, 2004

Payment Method	Annual Total		Daily Average	
	<i>Items</i>	<i>Trillions of Dollars</i>	<i>Items</i>	<i>Billions of Dollars</i>
Checks	14B	14	55M	56
Automated clearinghouse	6B	13	26M	50
Government securities	20M	313	80K	1,239
Transfer of funds	125M	470	494K	1,857
Cash (currency processed)	36B	0.6	144M	2

Payment Instrument Trends

1990 – 2003 (in billions of transactions)

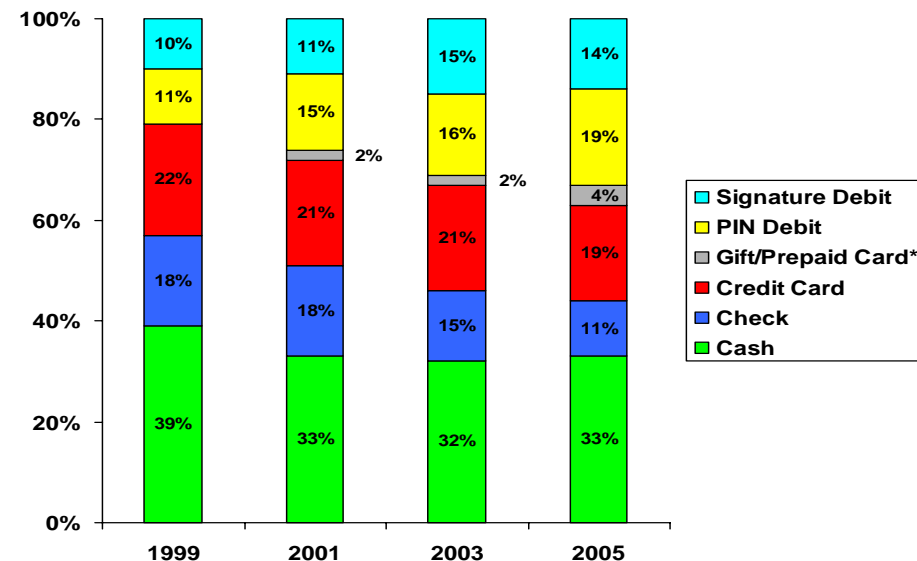


Consumer Behavior

In-Store Payments

- Electronic payment methods – particularly debit – account for an increasing share of consumers' in-store payments
 - Primarily at the expense of checks

In-Store Payment Mix, 1999 - 2005



*In 1999 and 2001, consumers were not asked specifically about prepaid cards; in 2001, the 2% is "other."

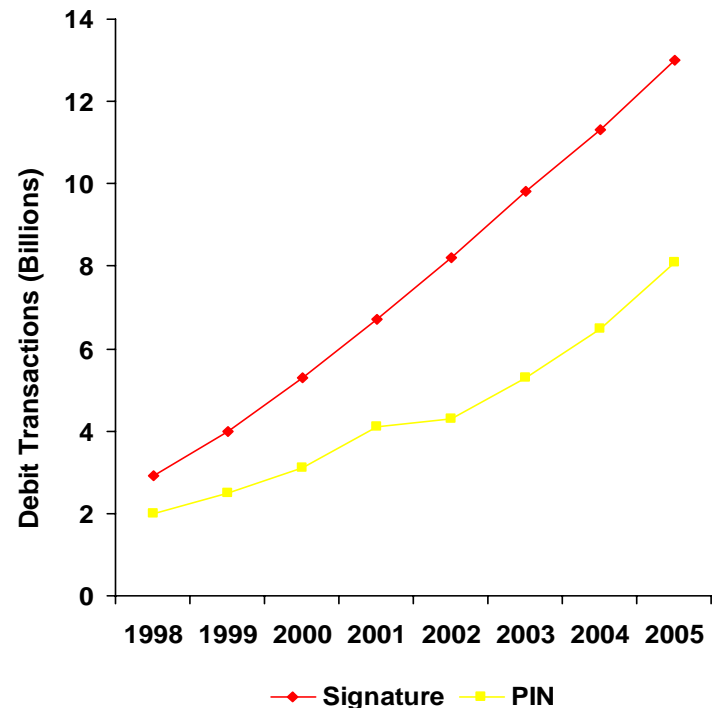
Source: 2005/2006Dove/ABA Study of Consumer Payment Preferences

Consumer Behavior

Debit Cards

- Debit's share of consumer payments continue to increase
 - In late 2002, Visa announced that Visa check card transactions exceeded Visa credit card transactions in the U.S.
- One-third of issuers currently offer a rewards program tied to their debit cards
 - 71% are for signature transactions
 - 29% are for all debit transactions (regardless of signature or PIN)

Debit Transaction Growth, 1998 - 2005



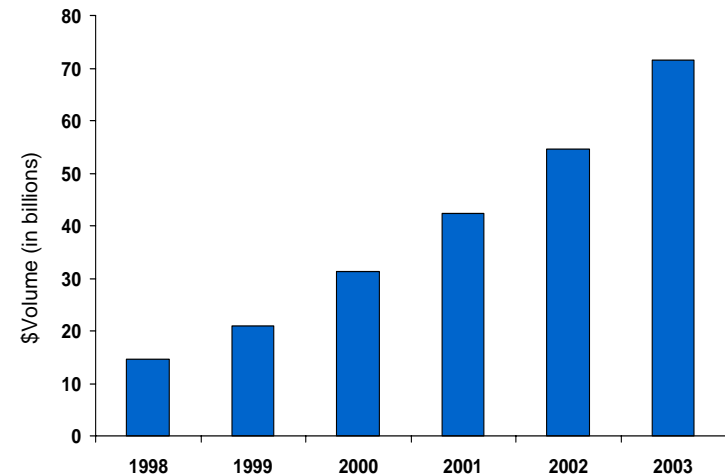
Source: 2005/2006 Dove/ABA Study of Consumer Payment Preferences

Consumer Behavior

Stored Value Cards (SVC)

- Growth of prepaid cards has been strong over the last few years, albeit starting from a small base
- Well-established
 - Gift/incentive cards
- Low-levels of penetration, but growing market share
 - Financial institution-issued, open-system cards
 - General purpose pre-paid cards
 - Travelers Cheque Card
 - Payroll/healthcare cards
 - Paycard (VISA branded)

Prepaid Market Growth



Source: The Nilson Report, 1998-2004 & 2005/2006 BA/Dove Study of Consumer Preferences

Consumer Behavior

Federal Reserve SVCs

- The Federal Reserve Bank of Boston provides smartcards to American military personnel at select Army peacekeeping bases overseas



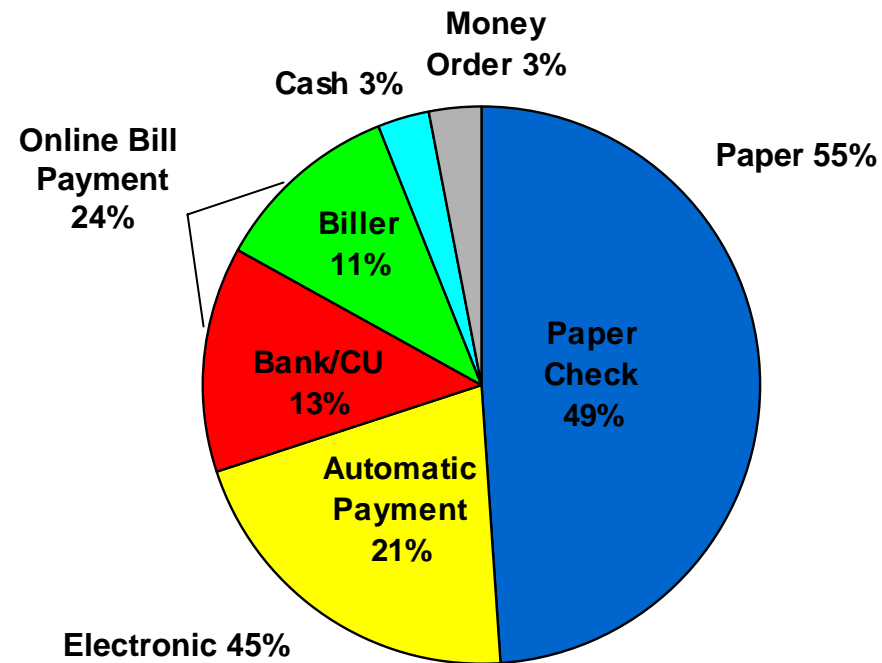
- EagleCash supplies smartcards to active military personnel abroad
 - To be deployed in Iraq and Kuwait this summer
 - 75 Kiosks
 - 1,000 POS Terminals
 - 55,000 Cards
- EZpay supplies smartcards to all five Army basic-training sites and several Marine training locations

Consumer Behavior

Bill Payments

- While checks maintain a higher penetration, consumers are shifting toward electronic bill payment methods
- Checks currently account for 49% of consumers' bill payments, down from 72% in 2001 and 60% in 2003

Recurring Bill Payment Mix



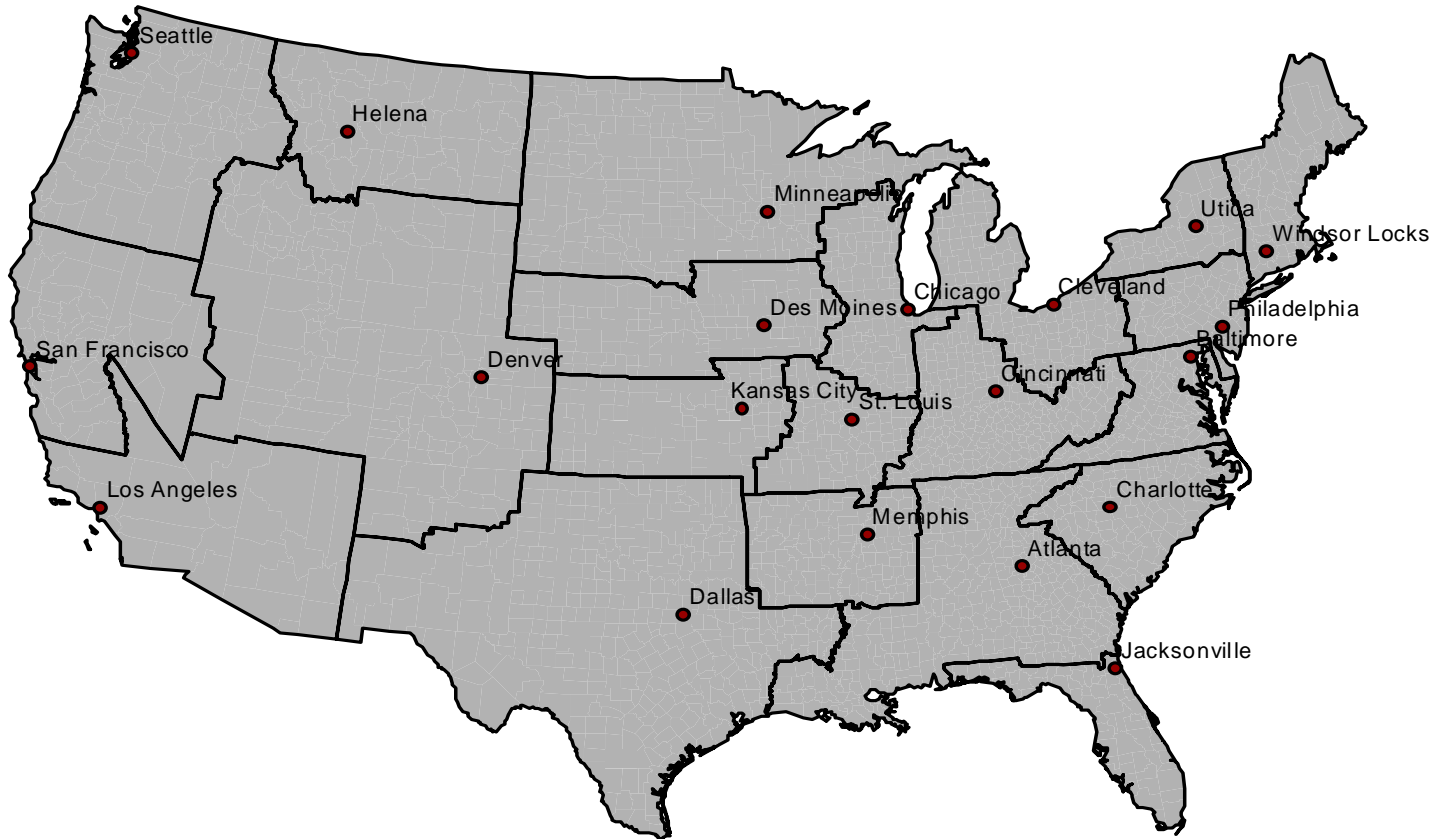
Source: 2005/2006 Dove/ABA Study of Consumer Payment Preferences

What do these payment trends mean for providers of payment services?

- Electronic systems that support this shift in consumer payment behavior must be flexible, nimble, and scalable
 - Reliable and high availability
 - Highly secure; consumers are concerned about fraud

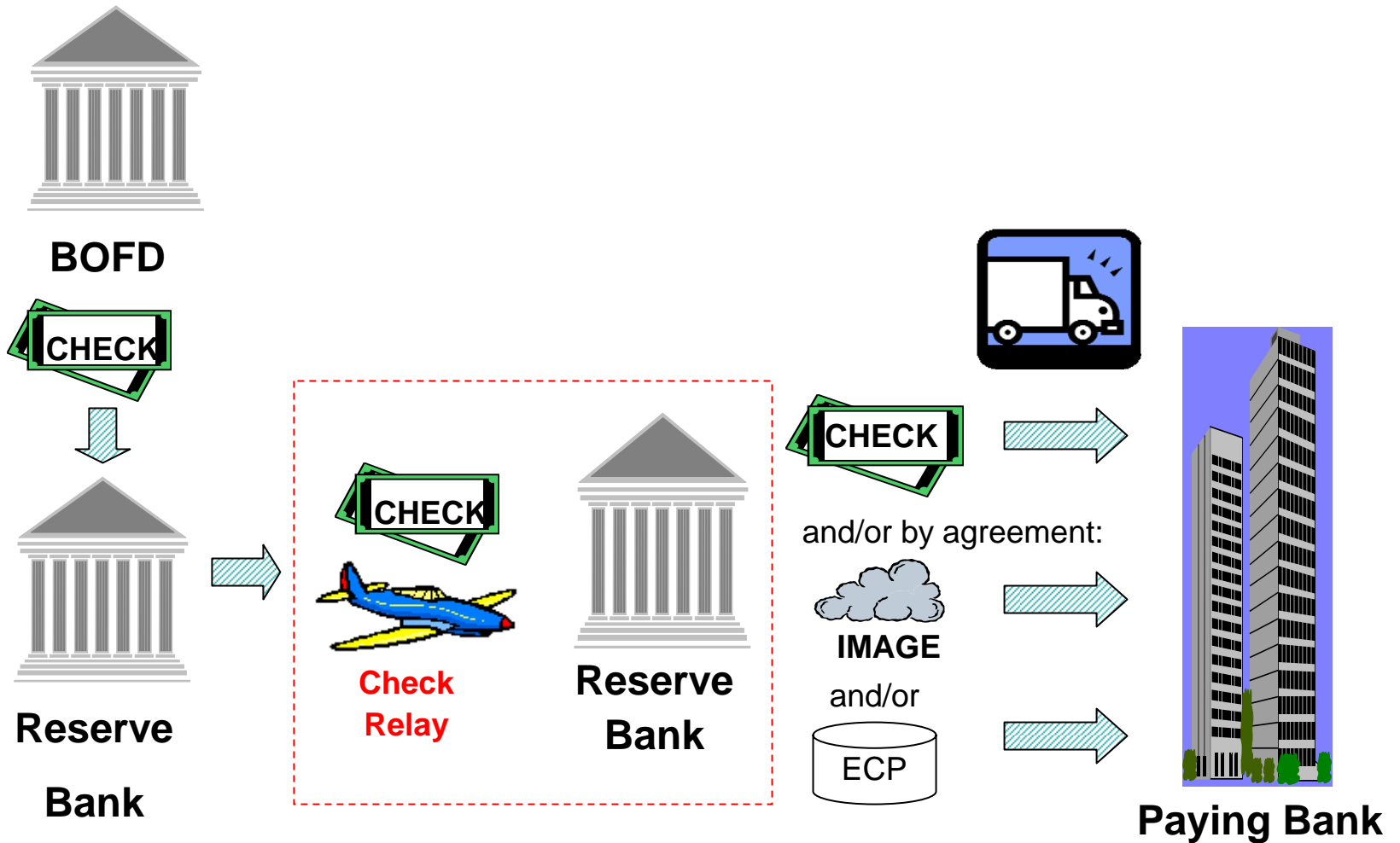
- Check processing and operating costs are high
 - Check infrastructure needs to be reduced quickly in response to ongoing volume declines
 - Innovations in check clearing and new payment channels are needed to reduce high operating and transportation costs
 - i.e., Check 21, ACH conversion, Online banking

Federal Reserve Check Processing Territories in 2007

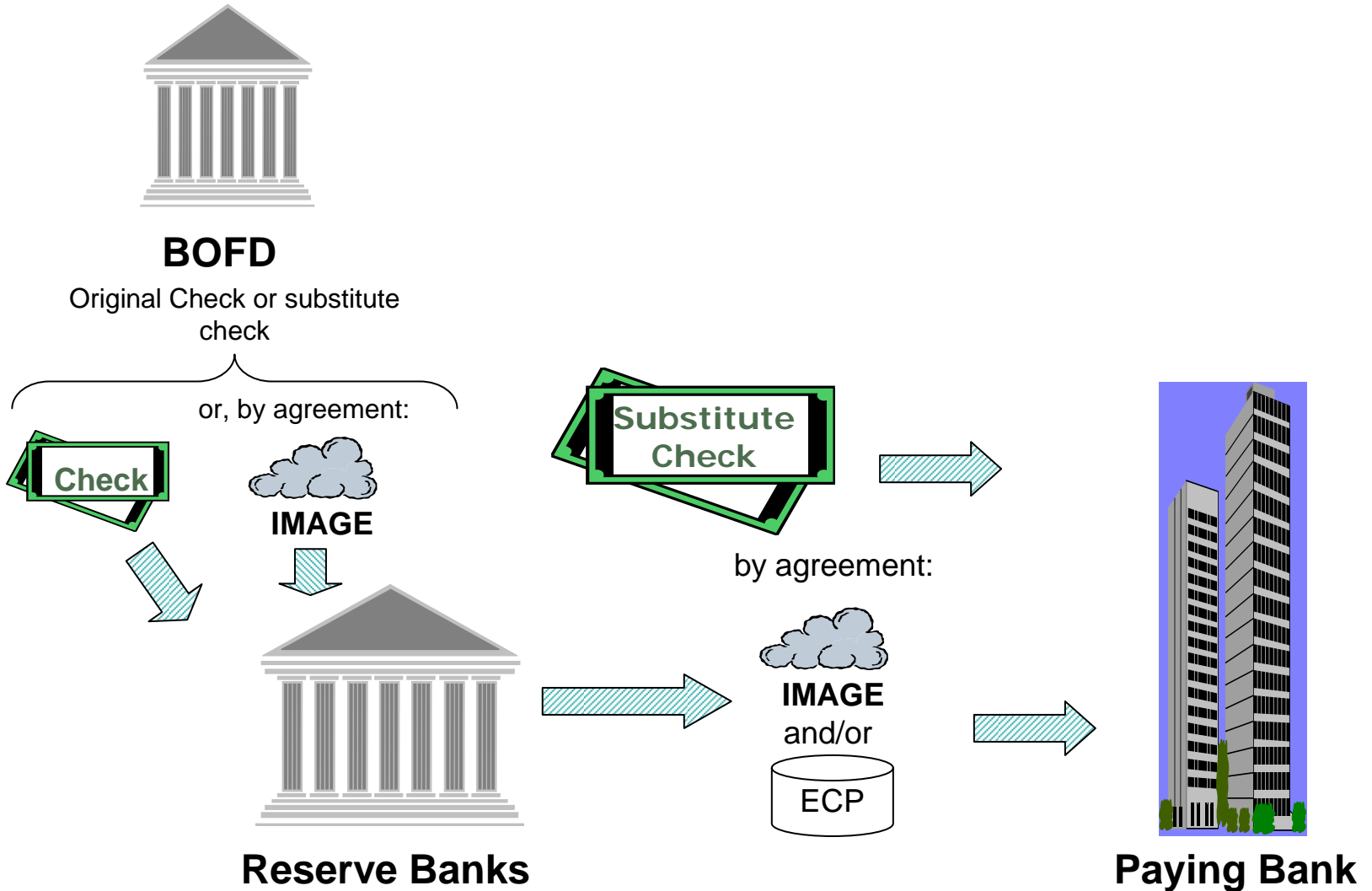


22 Processing Offices

Check Collection Process



Check 21 Enabled Collection Process



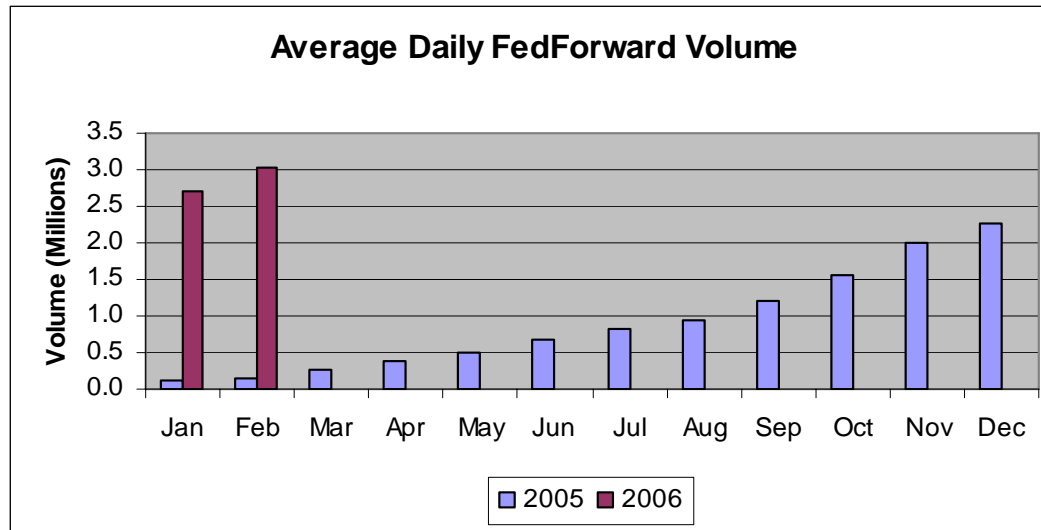
Check 21

- Check 21 leverages the use of check image technology to eliminate the need for multiple processing and delivery of paper checks
- Check Clearing for the 21st Century Act
 - Under law facilitates check electronification by authorizing the use of a substitute check as the legal equivalent of the original check
 - Does not mandate image exchange
- Federal Reserve Check 21 services
 - FedForward: electronic deposit of check images to the Fed
 - FedReturn: electronic return of check images to the Fed
 - FedReceipt/Plus: electronic receipt of check images from the Fed

Check 21

FedForward

■ Check 21 FedForward volume 2005-2006



- Averaged 3.1 million items per day, with a value of \$16 billion in February
- Represents over 6 percent of forward collection volume and 20 percent of forward collection dollars

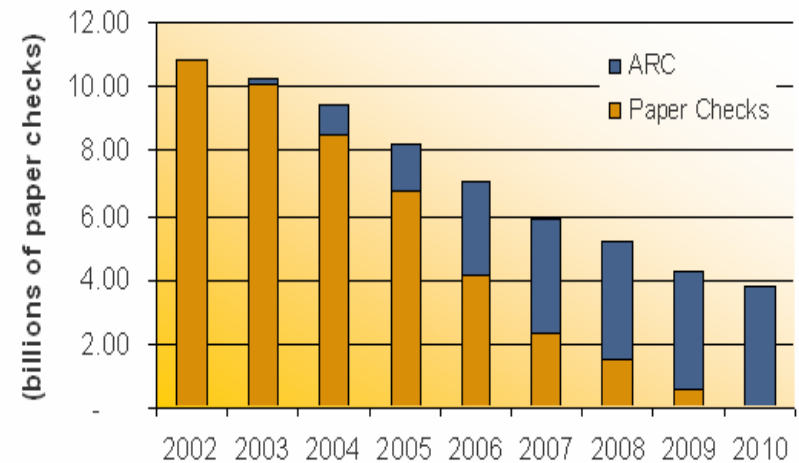
ACH

ARC

- Conversion of a consumer check received via mail to a single entry ACH debit
- “In just its third year in the marketplace, ARC has surpassed the 1-billion-payments-threshold, faster than any other payment application in the 33-year history of the ACH Network.”

—NACHA News Release, April 11, 2005

**Bill Payments – Paper Check and ARC
(received in a lockbox)**



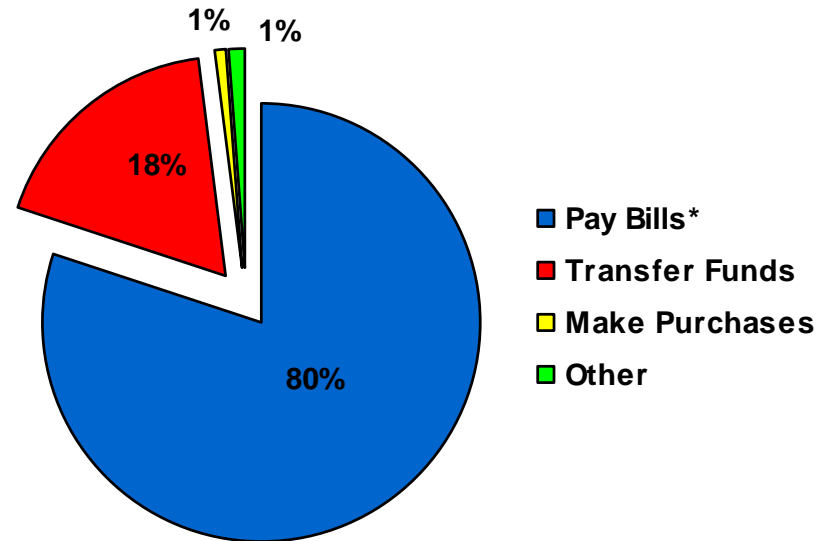
Source: NACHA and Celent Communications

ACH

WEB

- Single or recurring Internet initiated payments
- U.S. consumers initiated 967 million ACH debit payments via the Internet in 2004
 - Valued at over \$300 billion
 - 40% increase from 2003

ACH Internet Debit Payments, 2004



*via financial institutions' or billing services' web sites

Source: NACHA

Online Banking

- More and more financial institutions are offering online banking to customers
- Dove/ABA survey finding: In 2005 39% of consumers use online bill payment
 - 50% use the biller-direct method
 - 31% pay bills using their bank or credit union Web site
 - 19% use both methods
- Recent Retail Banking Satisfaction Study finds online banking is the preferred method among banking customers
 - With almost 3xs faster transaction times than interacting with a branch teller



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"There are advantages to online banking. We now know when we're overdrawn 50 times faster."

Implications for Credit Unions

- Credit unions are ahead of the curve
 - Have always truncated member checks
 - Faster to move to electronic statements and paper statements without checks

- EasCorp performs back office functions
 - Early adopter of Check 21 services benefiting clients
 - FedForward
 - FedReturn
 - FedReceipt/Plus

 - Deploying remote capture at client branches and depositing checks with the Fed electronically

Implications for Credit Unions

- New customer services and payment methods will continue to grow and facilitate shift in payments system
 - ❑ Debit cards
 - ❑ Stored value cards
 - ❑ Online banking
 - ❑ Other new services?

Questions

