First Data
b›yond the transaction

A First Data White Paper

In-Store Electronic Checks Make Payment by Check Safe, Fast, and Low Cost

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Introduction

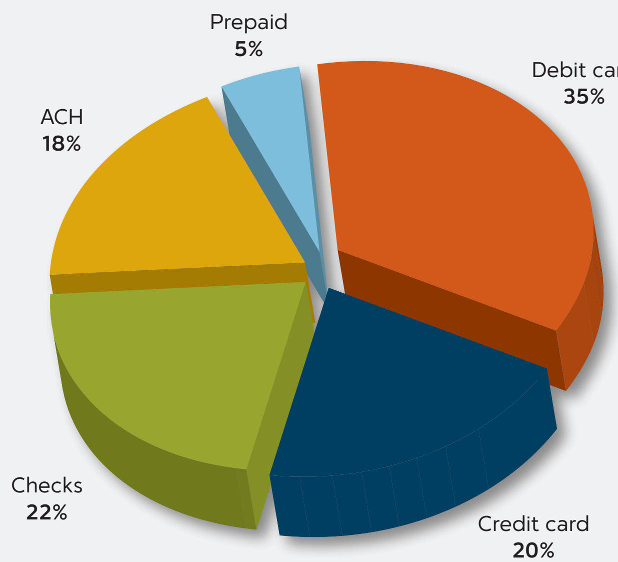
It's no secret that the use of paper checks has been in long-term decline. Less recognized, however, is the pivotal role checking accounts still play in payments. Even though checks now account for less than a quarter of non-cash payments, 75 percent of non-cash payments come from three payment types linked to DDA accounts: checks, debit cards, and ACH payments.

In 2009 (the most recent year for which data is available), paper checks were still the most widely used non-cash payment instrument, with more than 85 percent of consumers using checks during the prior year or having checks available for use. The same study found that 31 percent of consumers used paper checks at least monthly in 2009 for purchases in retail stores.[i]

Why do consumers still write checks? Key reasons include:

- Out of habit
- Preference to pay now rather than later
- For record-keeping purposes, especially for high-dollar transactions and bill payments
- To take advantage of "the float" to delay drawing down their DDA accounts
- To avoid the use of debit and credit cards
- Because they may not have a debit or credit card or may have exhausted their credit limit

75% OF NON-CASH PAYMENTS INVOLVE DDA ACCESS



Source: The 2010 Federal Reserve Payments Study. Federal Reserve System, April 5, 2011.

Many merchants, however, consider the processing and handling of traditional paper checks as burdensome and risky when compared to other forms of payment. In some instances, retailers have opted to no longer accept paper checks. This, however, may be a shortsighted solution. Consumers still use checks for 22 percent of all non-cash payments, indicating that there are many who prefer to pay in this way. Accordingly, refusing to accept checks risks losing sales and alienating a significant number of customers.

Fortunately for merchants, there is another way to accept payment by check that simplifies the check handling process and virtually eliminates the risk of bad checks. This payment option, known as electronic check acceptance, automatically converts paper checks into electronic payments at the point of purchase. Not only are electronic checks easier to handle than paper checks, they cost merchants less than paper checks and are generally comparable in cost to payment card and cash transactions.

What Are Electronic Checks?

An electronic check is a payment transaction authorized by a consumer for processing through the automated clearinghouse (ACH) network. The transaction data includes payment amount along with consumer-supplied bank account information. The information contained on the face of a paper check can be automatically converted into an electronic check in seconds, or the necessary information can be obtained from the consumer by telephone, online, or in writing.

The four primary situations where various types of electronic checks are used:

1. Conversion of paper checks received in person at the point of purchase, in the mail, or from a lockbox.
2. Phone orders (with check information supplied by buyer).
3. Internet orders (the buyer enters check information for Internet check acceptance, also known as "e-checks").
4. Funding and reloading a prepaid card or account, such as Google Payments or PayPal, from DDA accounts. This payment type is often used to pay bills and make purchases either online or in stores.

This paper specifically focuses on electronic check conversion at the point of purchase (POP). These are payments presented at the point of purchase as paper checks, which are then converted for electronic processing via the ACH settlement network. No investment in expensive imaging equipment is needed for checkouts equipped with magnetic ink character recognition (MICR) readers; checks converted through the use of MICR readers do not have to be imaged. (Note that a Check 21 solution, which does entail imaging, may be preferable for certain types of merchants). A small percentage of presented checks (generally corporate checks, money orders, and checks written from banks that don't participate in the ACH network) must remain paper checks; in these cases, the payment processor declines to convert the check and prompts cashiers to submit it for deposit at their bank.

ACH-ready electronic checks have the advantage of being processed much faster and at a much lower cost than paper checks. Although merchants can convert paper checks in the back office for ACH settlement, there are substantial efficiencies associated with in-lane conversion.

How does the process of accepting electronic checks compare with accepting traditional paper checks? Consider the process comparison in the following table:

Processing a Conventional Paper Check	Processing a POP Electronic Check
1. When the ticket has been totaled, the customer fills out the entire face of the check. 2. The cashier may call a manager over for approval, or submit the check for approval or denial through an outside service. 3. Accepted checks are stored in each lane's cash drawer for end-of-day processing. 4. Back office personnel prepare a deposit slip for all checks. 5. The batch of checks is transported to the bank for deposit. 6. Banks credit funds to the merchant depending on their policies, which may be up to seven days for checks drawn on out-of-state banks	1. When the ticket has been totaled, the customer hands a blank check to the cashier. 2. The cashier runs the check through a MICR reader and enters any required identifiers such as driver's license information. 3. Information for a risk management inquiry is automatically transmitted in real time to an electronic check acceptance service provider. ACH-eligible transactions that meet risk management standards are approved almost instantly. 4. The customer signs a transaction authorization pad and receives the voided paper check with amount, date, and to-the-order-of completed, providing a complete record along with the transaction receipt. 5. No other handling is involved. Funds are automatically deposited into the merchant's bank account in a manner similar to a credit card transaction. Funding usually occurs within 48 hours.

It is important to note that paper and electronic checks share two risks: insufficient funds and fraud. For paper checks, some merchants choose to mitigate these threats by using an acceptance service to screen out risky check writers at the point of purchase (although many do not). The same approach can be used for electronic checks. Through acceptance services, merchants have three ways to alleviate transaction risks:

- **Warranty for 100 percent protection.** Some service providers offer full processing services, including warranties that guarantee payment on all approved transactions. This service effectively transfers all approved transaction risk from the merchant to the service provider. The service provider handles all aspects of collection and absorbs any losses.
- **Verification.** A minimal verification service involves a real-time validation of a consumer's identity. This verification process also includes a negative database check to determine if the check writer has any current unpaid debts.
- **Collection.** For an optional fee, some acceptance service providers also take a proactive role in the collections process. When an approved electronic check fails to clear, the service provider will perform collection efforts on the merchant's behalf.

Advantages of Electronic Check Acceptance

Paper checks can have costly drawbacks for merchants. From the point of purchase through back-office accounting, settlement and possible collection, the process can be laden with fees, potential inaccuracies, inefficiencies, and loss risks. Merchants want to keep the patronage of check writers, yet they wonder how they can efficiently continue to serve the sizeable percentage of consumers who still prefer to pay with paper checks.

Fortunately, electronic checks offer significant advantages over paper checks for merchants and consumers:

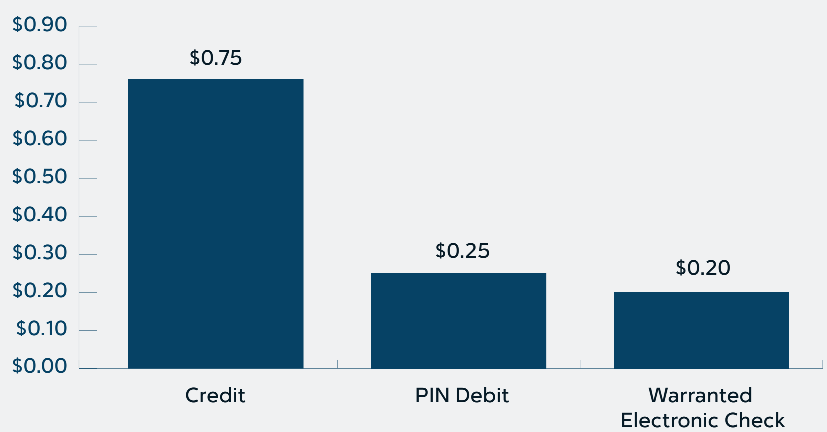
Operational efficiency. With less time spent on handling, batching, and accounting for checks from all lanes, store personnel have more time to focus on sales, operations, and customer service.

Enhanced security. No sensitive information is visible or accessible to cashiers and back-office staff. When a transaction is accepted, the customer leaves with the voided paper check in hand.

Lower costs from bank fees. Depending on the acceptance service provider, merchants can reduce bank deposit fees and returned check fees (which can be $5 to $30 per returned check). In some cases the provider may absorb these fees.

Lower processing costs. Payment processing costs are lower for electronic checks than for credit card transactions and paper checks—and are comparable to debit card transaction costs. A First Data analysis of transaction processing costs found that the average merchant processing cost for a $40 point-of-sale ticket is $0.76 for credit cards, $0.25 for debit cards, and $0.20 for electronic checks.

AVERAGE MERCHANT POINT-OF-SALE PROCESSING COST FOR A $40 TICKET



Source: First Data Internal Analysis

Another perspective on comparative costs of payment types comes from the Federal Reserve Bank of Boston. Researchers estimated the costs of different payment instruments as a percentage of sale prices:[ii]

Payment Instrument	Estimated Cost as a Percent of Sale Price
Electronic (ACH)	<0.1%
Currency	0.5%
Debit card (PIN)	<0.1%
Paper check (not converted to ACH)	1.20%
Debit card (no PIN)	<0.1%
Credit card	2.00%

Although the Federal Reserve data does not compare electronic checks, this data suggests that the cost of handling warranted electronic checks is close to the cost of accepting other types of payments—meaning that merchants can provide customers with their preferred payment options while still optimizing payment acceptance costs.

Lower administrative costs. Additional savings result from the reduction in handling costs associated with the time and labor involved in manual processing of paper checks. Bounced checks, in particular, are fraught with heavy administrative costs, even if funds are ultimately collected. Check collections are streamlined because the authorization, settlement, and collections systems are fully integrated.

Faster funding. The ACH network processes electronic checks days faster than conventional checks are settled. This improves cash flow, eliminates much of the float cost incurred with conventional checks, and simplifies accounting and reconciliation processes.

Better risk management. Electronic checks can be more efficiently screened against a database of bad checks and other risk assessment parameters, with almost-instant approval or denial of the transaction. And thanks to a shortened cycle for returned checks, collections often improve. Of course, with a warranted electronic check solution, the merchant need not worry about collections for bad checks at all.

Streamlined accounting. Similar to credit card settlements, merchants receive funding for transactions as a single lump-sum credit, supported with payment detail of each transaction to facilitate speedy reconciliation. Authorizations are consistent chain-wide, as any employee who ignores instructions to decline a check will be revealed through automatic rejection of ACH conversion.

Lane speed is maintained at least at current levels and may be faster. At checkout, consumers no longer need to write amount, payee, date, and signature on the face of the check. Acceptance occurs in seconds.

For most merchants, the ability to accept electronic checks at the check-out is made possible with a simple software upgrade of the point-of-sale terminal equipment. Making this change will lower the cost while speeding the process of accepting checks at the point-of-sale.

Considerations When Choosing a Service Provider

In addition to their ongoing conversion services, the check acceptance service provider works with merchants to implement electronic check acceptance and integrate it with existing authorization, settlement, and collection processes. Merchants planning to adopt electronic check processing should look for these qualifications in a service provider:

- **Resources and product depth to implement electronic check processing as part of a larger payment processing service.** This is important because electronic check acceptance is just one kind of payment accepted at the checkout. If a merchant's payment processor supports electronic check acceptance, it can more efficiently incorporate electronic check processing into payment processing systems already in place.
- **Extensive experience with in-store payment processing for all types of payment**
- **Global reach and a large network of banking relationships.** This assures processing service consistency across even the largest merchant enterprises.

Beyond these general qualifications, a service provider's electronic check acceptance solution should have these capabilities:

- **Full family of check acceptance services for Internet, phone, POP, back office, Check 21, and lockbox needs.** This enables merchants to integrate electronic check acceptance across business channels.
- **Service offering with these characteristics:**
  - Can upgrade points of sale for electronic check acceptance without installing new hardware.
  - Range and flexibility of service options for settlement.
  - Low administrative return rate of non-bankable items.
  - Proven success in preventing and resolving exceptions.
  - Multi-lingual, licensed debt collections staff with proven performance record.
  - Multi-lingual, 24/7 customer care.
  - Commitment to supporting future payment solutions.
- **Robust risk management engine with risk modeling capabilities that can be customized to meet specific merchant requirements.** This should include these capabilities and characteristics:
  - Choice of risk management service levels.
  - Track record of working closely with law enforcement to address fraud.
  - Continual monitoring of fraud patterns.
  - Ability to segment and manage the variables of fraud prevention for different customer groups, stores, product segments or geographic areas.
  - Sophisticated verification processes and fraud prevention tools supported by veteran experts.
  - Extensive negative and activity databases to evaluate check-writer risks.
  - Ability to access histories on at least 97 percent of check writers.
  - Sophisticated encryption, transaction ID, and data storage techniques.
- **Commitment to supporting future payment solutions.** With the emergence of online and mobile commerce, consumers' shopping and payment preferences are changing the face of commerce. A service provider should understand payment trends and be in a position to transform their service offerings to meet a merchant's needs.

Conclusion

Electronic check acceptance at the point of purchase is an appealing option for merchants that want to maximize customer satisfaction and improve profitability. Merchants can achieve significant savings and cost efficiencies by offering this payment instrument.

Research has shown that substantial numbers of consumers still prefer to pay by check, and will continue to do so. Consumers who prefer to pay with their DDA accounts, but do not have or wish to use a debit card, appreciate the speed and convenience of electronic checks. For any given store, more shoppers would likely opt for electronic checks if real-time conversion and acceptance services were offered during checkout.

Merchants should also bear in mind that electronic check acceptance is a bridge for merchants preparing to join the rapidly developing trend to mobile payments and other next-generation solutions that enable consumers to pay from their checking accounts without a paper check. According to Carl Scheible, Managing Director of PayPal U.K., "By 2016, you'll be able to leave your wallet at home and use your mobile as the 21st century digital wallet."[iii] Merchants that have implemented electronic checks may enjoy a head start in implementing any forthcoming ACH payment solutions that may emerge.

For more information about electronic checks and what is involved enabling electronic check acceptance at the point of sale, contact your sales representative or visit FirstData.com.

The Global Leader in Electronic Commerce

Around the world every day, First Data makes payment transactions secure, fast and easy for merchants, financial institutions and their customers. We leverage our unparalleled product portfolio and expertise to deliver processing solutions that drive customer revenue and profitability. Whether the payment is by debit or credit, gift card, check or mobile phone, online or at the point of sale, First Data helps you maximize value for your business.

Sources

[i] "The 2009 Survey of Consumer Payment Choice," April 2011 version. A public policy discussion paper, Federal Reserve Bank of Boston.

[ii] *ibid*

[iii] O'Connell, Brian. "Mobile Payments Could Replace Cash By 2016." Investopedia. January 12, 2012.