



All eyes are upon...the amazing growth of electronic payments

The summary report on the *2007 Federal Reserve Payments Study* is now available. This study is part of an ongoing effort by the Federal Reserve System to measure trends in noncash payments in the United States.

Similar to previous studies, the current study included two data collection efforts to estimate the annual number and value of noncash payments in the United States for 2006: The *Depository Institutions Payments Study* collected data from more than 1,400 financial depository institutions and the *Electronic Payments Study* included responses from 65 of the largest payment networks and card issuers.

This year's study aligns with our past efforts in 2001 and 2004, providing another snapshot of the continuing evolution of the payments system. The 2007 study provides a point-in-time picture from which all financial services industry participants and the Federal Reserve Banks can draw inferences about the rate and nature of the change in the United States payments system.

Among the various findings revealed in the latest study, one of the most significant is that the adoption of electronic payments is gaining momentum throughout the nation. The previous study showed that about half of noncash payments in the United States were electronic in 2003. The new study reveals that in 2006, three years hence, electronic payments had already comprised over two-thirds of all noncash payments.

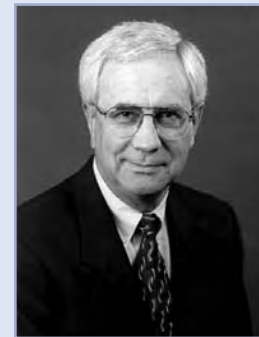
While electronic payments are hardly new, with the accelerating adoption of electronic payments throughout the nation, the financial services landscape looks new. As the electronic payments environment grows, the Federal Reserve Banks will continue to deliver product offerings for financial institutions of all sizes that can help them capitalize on growth and revenue opportunities. Our Check 21-enabled product suite, FedACH® Services and paper check processing services are designed to provide the accessibility and flexibility financial institutions need to compete in this "new" environment.

Together, we can take steps to respond to the changing market conditions to manage the shift from paper to electronic payments, enabling a smooth transition.

Sincerely,

Richard Oliver

Executive Vice President
Retail Payments Office
Federal Reserve Bank of Atlanta



Electronic payments and electronic check clearing gain momentum

Over the past few years the financial services industry has experienced dramatic changes in the way payments are made and processed. The shift from paper to electronic alternatives has been remarkable. The *2007 Federal Reserve Payment Study* showed that, although rates of

the conversion of some checks into automated clearing house (ACH) payments for clearing and settlement. Moreover, the method for clearing the payments that remain as checks is increasingly electronic.

Electronic payments continue to outpace paper checks

Electronic payments now comprise two thirds of all noncash payments in number. The number of electronic payments, including debit card, credit card, ACH and electronic benefits transfer (EBT)¹ payments, grew 12.4 percent per year from 2003 to 2006. The proportion of electronic payments in noncash payments increased from 54.2 percent to 67.2 percent over the same period.

The number of ACH payments increased 18.6 percent per year over the last three years. In 2006, ACH payments grew by 5.8 billion since 2003, and over 2.2 billion of the additional payments were checks converted to ACH. In fact, the number of checks converted to ACH in 2006 was over eight times the number converted in 2003; converted checks now represent 17.6 percent of ACH volume.

Contributing to the growth in electronic payments is the increasing use of debit cards. For the first time the number of debit card payments exceeds the number of credit card payments. Debit card payments increased 17.5 percent per year from 2003 to 2006. PIN debit card payments increased more rapidly (20.6 percent per year) than signature debit card payments (15.8 percent per year). In 2006, 23.3 percent of noncash payments were made using credit cards. The number of credit card payments increased at the lowest rate of any electronic payments instrument (4.6 percent per year).²

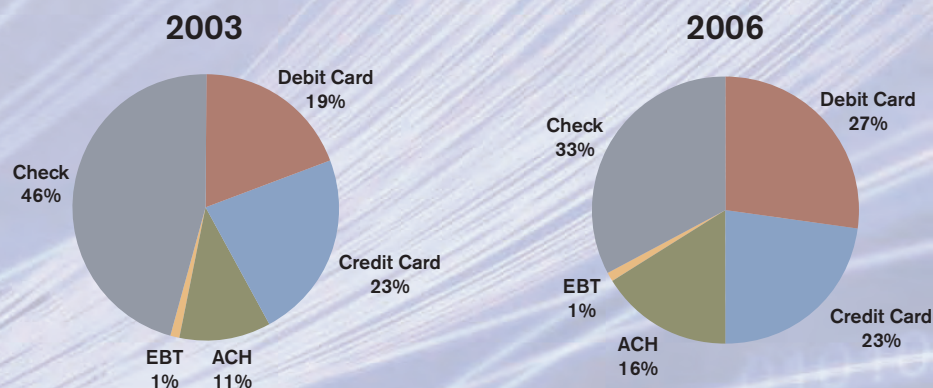
“The move to electronic payments is gaining momentum, requiring all parties involved in the payments system to review and evaluate their decisions about investments in technology to be sure they are keeping pace with these changes.”

Fred Herr, Senior Vice President
Federal Reserve Banks' Retail Payments Office

increase in electronic payments have declined in recent years, the amount of adoption has actually accelerated. From 2000 to 2003, the number of electronic payments per year increased by a respectable 13.5 billion. The latest study shows, however, that the increase in electronic payments per year from 2003 to 2006 was 18.6 billion, an increase that is more than one third larger than that of the previous three years.

Check payments are continuing to decline, in part, because payees are increasingly choosing to use electronic payments rather than checks and, in part, because of

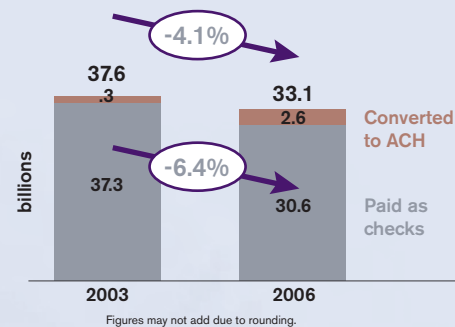
Distribution of the Number of Noncash Payments



Check clearing is increasingly electronic

The number of checks paid decreased 6.4 percent per year between 2003 and 2006, while the use of all other major instruments increased, for the same three-year period.³ Though the number of check payments is declining, check clearing is increasingly electronic, which enhances the efficiency of the check clearing system. At the time of the survey, about 40 percent of all interbank checks — those drawn on a different depository institution than the one at which they were deposited — involved the replacement of the original paper check with electronic payment information at some point in the collection process.⁴ The *2007 Federal Reserve Payments Study* also found that the number of checks returned unpaid decreased at the same rate as checks paid (6.4 percent) from 2003 through 2006.

Number of Checks Written, Paid and Converted to ACH



A summary report of the *2007 Federal Reserve Payments Study* is available at FRBservices.org/communications/payments_system_research.html. Detailed reports on the individual studies will be available in early 2008.

An all Check 21-enabled payment system is within sight

In just a little over three years, the Check 21 Act has transformed the check collection process at the same time that the payments industry is becoming increasingly electronic. The *2007 Federal Reserve Payments Study* released last month found that the number of checks paid declined by an average of 6.4 percent per year while electronic alternatives, such as debit and credit cards, are becoming an increasingly common form of payment.

These changes have led to a significant milestone in industry use and acceptance of Check 21. “This past September, more than 50 percent of the forward items processed by the Federal Reserve Banks were deposited in a FedForward® image cash letter, as opposed to traditional paper deposits,” stated Fred Herr, senior vice president in the Federal Reserve Banks’ Retail Payments Office. “It has taken us three years to move half of the forward volume to electronics, but we expect the remaining half to move much more quickly. We’re past the tipping point.”

Beyond the tipping point

With momentum working to move remaining financial institutions to electronics, the Federal Reserve Banks continue to judiciously downsize the legacy paper check

infrastructure. This effort involves reducing the number of check processing locations, simplifying the paper deposit product suite and transitioning customers from existing Payor Bank Services to FedReceipt® and FedReceipt Plus.

“Our customers are indeed rising to this transition challenge,” continues Herr. “They’re making the capital investments necessary for a change of this magnitude in order to provide their customers with better service. And, as more and more paper items are truncated early in the cycle, we see greater benefits achieved for the entire payment industry.”

What’s next?

What can you do to be better prepared on this side of the tipping point? “Our recommendation is that financial institutions position themselves for essentially an all-electronic payments world in the not-too-distant future,” Herr advises. “This means being able to send and receive forward and return image cash letters. We want our customers to be in the best position possible to enjoy the benefits afforded by an all Check 21-enabled payment system.”

¹ Signature debit card payments are made like credit card payments, but use funds from transaction deposit accounts. Personal identification number (PIN) debit card payments also use funds from transaction accounts and typically require the entry of the same PIN used to access automated teller machines (ATMs).

² Credit cards include both general purpose and private-label cards.

³ Checks paid include those cleared as original paper checks or substitute checks or via electronic check presentment or image exchange, but exclude checks converted to other forms of payment, such as ACH, for clearing and settlement. Because of ACH conversion, checks paid declined faster than checks written.

⁴ The depository institution survey collected information from March and April 2007. Based on industry data on the rapidly increasing use of electronic collection during 2006 and 2007, these percentages likely overstate the use of electronic collection in 2006, but understate its current use. The estimate includes substitute checks, which are checks that were converted to image during processing, but reconverted to paper for presentment to the paying depository institution.

Breakthrough services support your growing ACH business

With ACH payments increasing 18.6 percent per year from 2003 to 2006, monitoring risk and providing addenda translation services has never been more important. To help support your ACH payments business, the Federal Reserve Banks are introducing two new FedACH Services in 2008: FedACH Risk® RDFI File Alert Service and FedEDI® Plus.

Available to FedACH Information Services Subscribers via the FedLine Web® and FedLine Advantage® access solutions, the additional automation, flexibility and assurance can be yours by simply completing the appropriate section(s) of the FedACH Participation Agreement.

FedACH Risk RDFI File Alert Service (available 1st Quarter)

As the latest addition to the suite of FedACH Risk Management Services, the FedACH Risk RDFI File Alert Service provides control features for the Receiving Depository Financial Institution (RDFI).

The service provides monitoring thresholds and notification features to facilitate risk management by making the ACH network more transparent to RDFIs — even for RDFIs that outsource their FedACH processing or that have complex organizational structures.

The service improves the RDFI's view of incoming ACH files by alerting the RDFI of abnormal circumstances that may impact its Fed account. It also monitors a RDFI routing transit number (RTN) by scanning individual FedACH output files upon release to the RDFI's receiving point — one file at a time — without interfering with payments processing.

Subscribers can set thresholds (debit and/or credit dollar amount and/or addenda/item count) for FedACH output files. When a file destined for an RDFI exceeds these defined

thresholds — contains a larger than expected number of entry/addenda or exceeds the expected dollar amount — an e-mail alert will be sent to the RDFI's designated point(s) of contact.

FedEDI Plus (available 2008)

A new and improved version of our Electronic Data Interchange (EDI) software will replace the standalone solution available since 1998. Gone are the days of requesting and installing software and importing payment or supporting files — all data will be housed online, eliminating the need to input payment or information files. FedEDI Plus will still translate payment and remittance information within ACH records into human-readable reports, enabling RDFIs' customers to match ACH payments to invoices and payroll records. But, FedEDI Plus brings so much more (See "Ushering in a new era for FedEDI" in the September 2007 *FedFocus*).

The "Scheduled Reports" feature will be the primary way to use FedEDI Plus by defining actions to be performed by the service (RTNs, account numbers, report types, report formats and delivery options). Each night the service automatically looks at the previous day's information, produces reports and makes them available in the preferred format: PDF, TXT or HTML. Header information, such as financial institution name and logo, can be added to the reports. An "On Demand" feature is also available to run reports for various date ranges and customer IDs in real time.

Rich Oliver's letter on page 1A promises that Reserve Banks would continue delivering innovative, progressive services. In turn, subsequent releases of FedEDI Plus will include additional reports and enhanced functionality and support for NACHA-formatted, un-translated data files. To streamline processing, these files will be accepted directly into some Accounts Receivable systems to facilitate straight-through processing (STP).

Ask your customers if there are other reports or enhancements that they would like to see in the future; then share their feedback with your FedACH sales specialist. Your FedACH sales specialist can also assist you by running a custom calculator to model your expected FedEDI Plus usage and predict your monthly cost. Check out FRBservices.org for more information on these and other FedACH Services.

