



# The decade of native electronic payments: 2010 and beyond

By George F. Thomas

The decade that began in 2000 was one of significant change for the payments industry. Early in the decade, there was a movement toward consumer check conversion, where the paper check was still written but was subsequently used as a source document for an automated clearing house (ACH) debit entry. Billions of checks were and still are converted each year from paper to electronic debits.

Toward the middle of the decade, the payments industry spent significant resources implementing check truncation and image exchange after the passage of the Check 21 legislation, which provided the legal foundation for the substitute check. The substitute check allowed banks to truncate the original and use the substitute check for clearing and delivery to those customers that insisted on receiving a paper document. The introduction of remote capture and image exchange was so

successful that the exchange and clearing of paper checks diminished rapidly. Physical check clearing dropped so dramatically that the Federal Reserve eliminated most of its locations for check clearing and The Clearing House Payments Co. closed all of its paper check clearing operations by December 31, 2009, after 156 years of operation.

**What is a native electronic payment? One that is originated electronically and is received by the beneficiary in an automated manner without the use of paper.**

Also during the decade, we began to see the beginning of the movement toward native electronic payments—direct deposit

of payments continued to grow in popularity, consumers abandoned checks at the point of sale, and consumers paid more of their bills using recurring debits, Internet banking, and Web-based bill payment options. While there was much movement in the reduction of consumer checks written, many billions of payments still must be migrated to an electronic payments environment.

## The new decade

This year, 2010, marks the beginning of the decade where the transition to “native electronic payments” will be completed. Consumers will continue down the road of abandoning check writing. This trend is clearly evident with the younger generation that has no use for writing paper checks and is completely in sync with a pure electronic payment environment. The research

conducted over the last decade on the trends of business-to-business payments has clearly indicated

## “there is a tremendous momentum forming to eliminate the check as the payment instrument of choice for business activity.”

Businesses will automate the processes necessary to move to a native electronic payments environment, and over the next decade the check will no longer be the preferred business payment method.

Consumers have adopted electronic payment technology more rapidly than businesses. The reason for this is quite simple: Consumer payments are less complicated than business payments, and the tools for initiating electronic payments were put into place for consumers.

Banks and other members of the payment industry have not, until recently, provided the necessary tools for initiating and receiving business-to-business payments. Bank cash management packages and accounting packages for small and mid-sized businesses did not have the ability to originate business payments with enough payment detail for the receiving business to automatically reconcile and post the electronic payment to the originator's account. There was no standard format for conveying the necessary data elements for automated posting until the introduction in 2002 of the STP 820 by The Clearing House Payments Co., the simplification of a business payment format that had existed for several decades. The STP 820 defined the data elements necessary to facilitate automated posting of an electronic payment by mirroring electronically the information contained in a check stub or invoice that accompanied a check payment.

Significant progress has been made to provide the on and off ramps necessary for businesses to access the electronic payments highway, which is nearly complete.

### The electronic payments highway

A next-day payment capability for business-to-business payments has existed in the United States since 1988 with the introduction of the corporate trade exchange format for the ACH. This business-friendly structured format can carry ample payment remittance information. The ACH is ready to meet the needs of the business customers for moving to an electronic payments environment.

The real-time large-value payments system Fedwire, operated by the Federal Reserve Banks, is used frequently for business payments both internationally and domestically. But it does not have the ability to carry structured payment remittance information and only provides 140 characters of unstructured payment detail. The other real-time large-value payment system, CHIPS, operated by the Clearing House Payment System, has had the capability of carrying structured remittance information since 2001.

After reams of corporate research and extreme efforts by the Association of Financial Professionals (AFP) to convince the banks and the management of Fedwire that it was essential to add structured remittance to the wire transfer systems, Fedwire agreed to put the capability in place by the end of 2010. There are a couple of large banks that are still resisting this needed improvement to the electronic payments infrastructure. Let's hope Fedwire keeps its commitment to implement this capability this year and the banks that see the future build the on and off ramps necessary to make this payment system viable for business-to-business payments.

### Image exchange and remote capture

The float that businesses enjoyed with the check collection system has been almost completely eliminated with the advent of remote capture and image exchange. In fact, a check that is received today in the mail can be captured, transmitted, and posted by the beneficiary in the same day, reducing the float that companies have come to depend on. The paying company now must guess when the check issued will ultimately clear. Image exchange has significantly reduced the check clearing time and created serious issues for a company that was relying on float to manage its disbursements—not an exact science for managing a company's cash flow. An electronic payment, on the other hand, provides complete disbursement control for the paying company by controlling exactly when a payment will be received and settled.

Electronic payments will increase the velocity of payment activity and, as a result, the improvement of the economic business cycle. A company receiving payments more quickly can make its payments more rapidly. We saw this result when checks were moved to electronic payments on the large-value payment systems. In the 1970s, approximately \$3 billion was exchanged daily in large-value check payments. By the 1980s, that figure grew to \$400 billion, and by 2009, it was at \$4 trillion. These systems were necessary to support the economic growth that has occurred over the last 40 years. Electronic payments will facilitate the growth of businesses now and into the future.

### Payment fraud

The annual AFP Payment Risk Surveys have consistently shown that the check is the riskiest payment instrument. This risk alone

should provide enough incentive for businesses to begin moving away from using it.

As payments move away from check systems, the crooks will also migrate to electronic payment systems to look for weaknesses and vulnerabilities. The electronic payment networks are very secure, but the banks need to ensure that the access to these systems is, too.

In 2009, we saw sophisticated thieves who were able to exploit the electronic payment systems to commit fraud. The weakness was not in the electronic payment networks but in the security procedures that permitted access to the payment initiation systems provided by the banks. In every case that I am aware of, the companies that suffered losses did so as a direct result of their banks not offering multi-factor authentication or weaknesses in their implementation of such systems. Companies must demand that their banks provide the necessary systems to ensure the safety of their payment activity or move to a bank that does.

### Predictions

Consumer payments will continue to rapidly move from check to electronic means. This is evident by the recent statistics provided by NACHA, The Electronics Payment Association, which show check conversion volumes are dropping precipitously while native electronic payment applications have been showing consistent growth. Account-to-account (e.g. person-to-person) payments will move from check to electronic payments and become a new growth opportunity for the ACH.

There are 4 billion to 5 billion business check payments that can be moved to electronic payment mechanisms such as purchasing cards, ACH, or wire transfer. The effort this year and over the next decade should be focused on the payment industry providing the right tools for businesses to initiate and receive payments in an automated environment. Companies must begin to change their payment processes to gain the benefits and efficiencies that an electronic payments environment offers.

The electronic payments trend has begun. Over the last couple of years, we have seen corporate trade payments growing at double-digit rates. As companies begin their migration to electronic payments, these growth rates should increase exponentially.

The change will be slow and painful, but my prediction is that by the end of the decade, consumers and businesses will no longer be issuing paper checks. If you check my track record of predicting electronic payment trends, you will see that “Nostradamus Thomas” has rarely been wrong. ●

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