E·FUNDS℠

Retail Industry
NEWSLETTER

Rahul Gupta, Senior Vice President and Division Executive

Welcome!

On behalf of the Retail Industry team and everyone at eFunds, I would like to welcome all of our customers to the first edition of the eFunds Retail Industry Newsletter. At this year's SCAN Conference, the clear message from you, our customers, was that you expected eFunds to provide leadership on issues impacting the Retail industry. One crucial component of industry leadership is effective communication. With that goal, this Retail Industry Newsletter will serve as one of the key channels for eFunds to communicate, educate, and engage our customers.

In this issue, our product organization reviews the important functionality included in our March, 2004 release as well as our August release scheduled for later this month. We have also focused on one of the big industry discussion topics and a subject of much debate at our SCAN Conference — Check 21. I hope you find our feature article, "Check 21: Raising Opportunities for Retailers" to be helpful in advancing your understanding of this important change in the check processing business. eFunds is focused on this upcoming legislation and its impact on both our retail and banking customers.

As an industry leader, eFunds has core capabilities including ACH processing, Check Authorization, Risk Management, and imaging/encoding centers

to deliver comprehensive solutions in a Check 21 environment. We are actively engaged with several of our largest Retail customers in an evaluation of their check processing operations and analysis of cost savings tied to back-office check conversion and deposit automation. I encourage you to contact your Account Manager and engage eFunds in a similar review.

As you read this first edition of our Retail Industry Newsletter, it is my hope that you will see eFunds stepping up to the challenge of providing industry leadership. With your support and feedback, we are poised for this challenge today and through the years to come. ■

In This Issue

IN THIS ISSUE

SCAN

Product Update

I would like to welcome you to the eFunds Retail Industry Newsletter. As Director, Retail Product, I am looking forward to using this forum to keep our customers updated on our product plans and upcoming releases.

The first half of 2004 has seen a number of important enhancements to our SCAN and SCAN OnLine solutions. These enhancements are designed to provide an enhanced check writing experience for your valued customers while also building the foundation for a number of new fraud prevention tools to be introduced in 2005.

March, 2004 Release — New Enhancements

In March, at the SCAN Conference, we unveiled three major enhancements that will improve the check writing experience of your customers and increase your check sales.

1. **Scored Negative:** For both SCAN and SCAN OnLine customers, we introduced our Scored Negative File, which will significantly reduce "nuisance hits" at the POS. Through our proprietary scoring environment, we are able to identify the probability that the next check written on a negative account will be a good check. Thus, your customers who are "casual" NSF check writers will no longer appear on the negative file provided they pay their outstanding checks within 30 days. You are able to choose the appropriate risk threshold with Scored Negative. For example, Scoring can be set to 90% so only those customers with a 90% chance of their next check being good will receive Approvals. For SCAN OnLine customers, you can choose the level of risk at the Risk Strategy level.

2. **Frequent Shopper:** We also introduced our Frequent Shopper functionality for SCAN OnLine. SCAN OnLine will now automatically identify frequent good check writers and provide them with increased velocity limits, thus reducing the chance that your best customers will be impacted by the decline of a higher dollar check. For each risk strategy, the merchant can choose a velocity multiplier that will be applied. For example, if a multiplier of two (2) is selected, then the number and dollar amount of checks allowed for a frequent shopper (with no negative history) will be doubled.

3. **No ID Tender:** The March release also featured a No ID Tender function for SCAN OnLine. This function allows a retailer requiring a Driver's License to no longer have to ask the consumer for their DL if the system already has it linked to the Account Number. When a transaction is presented only the MICR will need to be sent to eFunds initially. If SCAN OnLine has a valid link to a DL, then the transaction is completed with the DL on record. If no valid link to a DL exists, then the cashier will be prompted to ask for the DL. This feature is optional and requires that the retailer's POS system support the ability to store the last transaction tendered.

Fall, 2004 Release

This month, we are introducing the ability for SCAN OnLine customers to have different risk strategies for different check types such as Government, Business and Personal Checks. To take advantage of this feature, the retailers Point-of- Sale system needs to support the ability to send the payment type code. Most systems have that ability, but it may require IT resources to properly implement.

Then, in September, 2004, we are rolling out a new version of our Web Reporting tool. This version is a major upgrade to our current reporting tool and includes the following new features, many of which were requested at this year's Retail Conference:

■ The ability to select reports by your District and/or Region

■ The ability to create and save custom batch reports which can be run on a scheduled basis (Daily, Weekly, Monthly)

Product Update
continued from page 2

- Expanded filtering capabilities to include Boolean functions (>, =, < etc.)

- Paper Non-compliance and Quarterly reports available via PDF for download

- Combined SCAN and SCAN OnLine non-compliance reporting

Fraud Strategy

At the March, 2004 eFunds Retails Advisory Board, a Fraud Focus Group was formed. This group met and discussed the growing problem of check fraud. The group recommended and the Advisory Board approved an update and expansion of the SCAN Contribution Specification. The new specification is designed to support the additional data needed to provide a comprehensive set of check fraud tools to be announced next year. The new specifications expand the number of Bank return reason codes supported by SCAN. It also supports the ability to contribute Name, Address and Phone Number.

The new SCAN Contribution Specification will be released in September, 2004. While we will continue to support the old specification, eFunds Account Managers will be working with our customers to determine the best course for expanding your

contribution. We encourage you to evaluate moving to the new specification to prepare the way for additional fraud tools in the future. For a copy of the new specification, please contact your Account Manager.

Check Fraud has been identified as our retail customers number one problem. This Fall, we will begin piloting solutions including 1st Deposit Scoring, ID Verification, and Bank Funds Verification. We are enthusiastic that these services will have a real positive impact on fraud losses. As the pilots are completed, we will report on results and our plans for making these and other solutions available to all our customers in a general release.

As always, my team and I are keenly interested in your feedback and suggestions. Please contact me at any time. Best Regards,

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Customer News & Notes

During the the first and second quarter, a number of customers renewed their SCAN service agreements or added additional services to enhance their Check Programs.

- Kohl's renewed its SCAN Agreement and plans to implement selective switch-out to SCAN OnLine for new, unknown customers. Kohls continues its expansion with the opening of 47 new stores already during its first quarter and 48 stores scheduled to open next quarter.

- Spartan Stores renewed its SCAN Agreement and added Drivers License file access to drive improved loss prevention and reduced fraud.

- U-Haul upgraded to SCAN OnLine as it rolls out a new POS system.

- Paymentech (reseller) added SCAN to its check authorization platform for e-Commerce customers.

- Safeway added Scored Negative to its implementation of SCAN.

- Pier 1 Imports renewed its SCAN agreement.

- Steinmart renewed its SCAN OnLine agreement.

- JC Penney renewed its SCAN Agreement.

- Shopko renewed its SCAN Agreement.

New SCAN Member

eFunds welcomes its newest retail customer and SCAN member — Bashas'. The Bashas' Family of Stores includes four distinct formats: Bashas', Bashas' Diné, AJ's Fine Foods and Food City. The company has more than 144 stores serving every county in Arizona, as well as Needles, California, and Crownpoint, New Mexico. ■

2004 eFunds SCAN Conference

Raising the Odds in Retail Risk Management

The 2004 eFunds SCAN User Conference was held in March at The Scottsdale Plaza Resort in Scottsdale, Arizona. Over fifty customers attended from across the country. They were joined by eFunds personnel from the Risk Management division as well as Global Outsourcing, ATM, and Electronic Processing divisions. The conference also was attended by several SCAN partners, value-added resellers, solution providers, and consultants. In all, over 100 people participated in the sessions and seminars.

It never rains in Scottsdale?

The theme for this year's conference was "Raising the Odds in Retail Risk Management". The conference was kicked off by Paul Walsh, eFunds Chairman and CEO. Paul welcomed our Retail customers and asked the attendees to continue pushing eFunds to deliver new solutions to their business problems. Rahul Gupta, SVP & Division Executive, added his welcome and provided insight on the new solutions eFunds would be introducing at the conference.

The first day of the SCAN Conference was focused on new Product introductions for SCAN and SCAN OnLine (see Product article). There were also a series

Tables heat up at Casino Night

of interactive and highly informative break-out sessions including; Web Reporting 2.0, Scoring/Consolidation & RCK, and Leveraging DebitBureau. The most highly attended, interactive, and informative session was the Check 21 Workshop moderated by Bob Hill, eFunds Director, Business Development.

This session served to help our customers identify just what is and is not known about the state of Check 21 legislation as well as the potential impact on retailer check acceptance. The session concluded with an agreement that confusion and misinformation was hampering retailers ability to analyze the opportunity for Check 21. Customers called on eFunds to take a leadership role in the education around Check 21 (see Check 21 article on page 4) as well as the development of solutions.

Another highlight of the 2004 Conference was our series of panel discussions. The first morning our customer panel discussion included leaders from Steinmart, Kohls, and Discount Tire. The panel's insight focused on several problems including Fraud which continue to be priorities for the industry. The second day was kicked off by an Industry Solutions Roundtable, which included CEOs from companies offering Fraud prevention solutions to both the banking and retail industries. This year's keynote speaker was Carol Coye Benson from Glenbrook Partners. Carol's presentation covered the full spectrum of Risk management challenges in today's retail environment as well as several emerging topics that retailers need to monitor.

The conference featured plenty of opportunity for peer networking and several lively social events. This year's feature event was an action-packed (and a little wet) Casino Night. Based on customer reaction, this may become a mainstay of future conferences. The feedback on our 2004 Conference was very positive and provided several good ideas for improving next year's conference.

The date for the 2005 eFunds Retail Industry Conference has already been set (March 23-25th). The conference will again be held at The Scottsdale Plaza Resort. So, mark your calendars now and plan to join us for an even bigger and better event. ■

Check 21: Raising Opportunities for Retailers

The new regulations regarding the Check Clearing Act for the 21st Century (a.k.a. Check 21) have had the financial service industry atwitter for the past several months as banks gear up to meet the October 2004 compliance deadline. With the advent of Check 21, financial institutions are now able to process check information electronically, truncating the paper check and using in its place a digitized image for subsequent processing and settlement. This image replacement document or substitute check, complying with specific requirements, is the legal equivalent of the original paper check. Banks are not required to truncate checks, but are required to accept substitute paper checks.

Maria T. Arminio
President and CEO
Avenue B Consulting, Inc.

Avenue B Consulting, Inc. is a management consulting firm focusing on payment systems products, services and technologies. The company offers a variety of services tailored to the payment system environment including business and strategic planning, new product development, product market validation, business and IT assessments, and competitive analyses.

The common misperception about Check 21 is that this legislation has a far reaching impact beyond the acceptance of the image replacement documents among financial institutions. It doesn't. In fact, the legislation does not necessarily advocate truncation, affect existing image exchange agreements, or impact retailer electronic check processing. However, there are advancements in electronic check processing that do impact the retail industry, namely electronic check conversion whether at the merchant point-of-presentment (POP) or in the back-office.

The adoption of electronic check conversion (ECC) began in 1999 as retailers began examining solutions to streamline check processing operations. In electronic check conversion, the source document (e.g., the check) is converted to an electronic ACH transaction that is legally covered under Regulation E. POP conversion is performed at the checkout area — and the franked check is returned to the consumer. The process requires check verification (identical to that which is being supported today for paper check acceptance), a MICR reader capability and, depending upon the type of program supported, an image capture capability. It is estimated that 220 million checks were converted at the point-of-sale in 2003.

Retailers tout the reduced cost of paper handling as a major incentive to implement electronic check conversion. The Federal Reserve's most recent annual report says that the cost to process a check is 4.5 cents per transaction compared to an ACH payment at 1.3 cents per transaction, thus providing an obvious financial incentive for the retailer. Other retailer benefits from ECC include early fraud detection, fewer errors, faster funds availability, more efficient cash management, and enhanced returns management through the early identification of non-sufficient funds (NSF) checks.

Why haven't all retailers jumped on the POP conversion bandwagon? Many large retailers claim that the capital investment for the imaging equipment at the point-of-sale sours the deal, even though the price of imaging equipment has dropped dramatically over the past few years. Installing image capture devices at every lane in a grocery chain, for example, is a costly proposition. Although the NACHA rules do not require retailers to image checks, many retailers feel that it is more difficult to support check collections if the check is not imaged. Absent the imaging device, the retailer must manage returns based on the customer's signature only.

The business case assessment for ECC at the merchant POP has been difficult to make by large retailers that have already built a high degree of efficiency in their back-office. In fact, some retailers are focusing on the opportunities for back-office conversion and deposit automation to garner the benefits afforded by ECC. The underlying process is straightforward. Checks are encoded, and the front and back of the check is imaged. Retailers must retain the physical check for 14 days before destroying. Using the captured image and other data, the deposit is proofed, scrubbed and balanced at the instant of capture, and the batch is created and electronically transmitted. Merchant deposit automation requires a secure connection to the acquiring bank for data and image transmission.

While these back-office processes may provide retailers with opportunities to further accelerate funds availability, reduce processing costs and lower overhead, the NACHA rules currently prohibit back-office conversion at the merchant. The NACHA ECC workgroup is meeting in late September to review

Check 21
continued from page 5

the revisions to the proposed rule for back-office conversion, and that document will be circulated for commentary shortly thereafter.

In the meantime, retailers should begin examining current check processing workflows and evaluate cost savings opportunities. The following checklist highlights potential areas for process improvement and cost reduction.

■ **Expedited funds availability:** Some retailers may be able to reduce the time frame for funds availability from 72 hours to 24-48 hours. Some of the benefits derived will depend upon the frequency with which merchants close out their batches for settlement.

■ **Reduced check losses by implementing authorization/guarantee services:** SCAN retailers already recognize this benefit, however, there are still large merchants or divisions within big companies that use no authorization services.

■ **Reduced cost of back office operations:** Evaluate the potential benefit of electronic item and value counting. Also assess the impact of automatic deposits which could reduce deposit preparation time by about two hours per week.

■ **Faster return item notification:** In some cases, notification could be reduced from 7 to 2 days,

thus improving opportunity for collections. Retailers using RCK services may already be realizing some of these benefits.

■ **Lower bank fees:** Check handling and encoding are eliminated, and thus retailer's fees for these services are eliminated.

■ **Other direct charges:** These may include armored car and courier services. Pundits have suggested that retailers can reduce merchant bank of deposit fees since check encoding in the back-office (the conversion) eliminates the need to make bank deposits. Yet, some retailers may not be able to reduce the fees for armored car services because of their cash volumes.

It is a safe bet that retailers will continue to search for ways to automate check processing from the point-of-presentment to posting, thereby minimizing overall processing costs, improving operating efficiencies and accelerating funds availability. It is anticipated that many retailers will build these capabilities into their own back-offices instead of utilizing the banks' proof of deposit or check operating centers to support these functions.

Although the legislation itself may be misunderstood, Check 21 may be the catalyst by which retailers move to support end-to-end electronic check processing. ■

Event Calendar

October 25–26th: **Retail Customer Advisory Board Meeting (Scottsdale, AZ)**

March 23–25, 2005: **eFunds Retail Industry User Conference (Scottsdale, AZ)**

We changed the name from SCAN User Conference, but the goal remains the same — provide the best forum for our Retail customers to network, learn, and share best practices. So mark your calendars now and plan to join us for the most productive (and entertaining) conference yet!

For more information or additional copies of this eFunds Retail Industry Newsletter, please contact your Account Manager or call us at 888–9eFunds (option 5).