The Myth of Paperless Payments

Conducted by
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OVERVIEW

For many years, pundits have been forecasting a cashless society spurred by an increase in electronic payment options. However, it is a common misconception that paper checks have become outdated and are no longer in wide use. Instead, as consumers and businesses progress through their lifecycles, there is a well documented and continuing need for checks. Also, since the digital transformation of the check afforded by Check 21 surpassed original intent and projections,[1] the written check today spends much of its life in the more cost-effective digital world. Awareness of the current trends in check usage and the changes in cost structures, as well as the drivers and barriers to check adoption, will help financial institutions (FIs) evaluate the significance of the check as a critical component of the demand deposit account (DDA). As FIs face implementation of the Durbin Amendment and other regulations, understanding the value and utilization of checks will help them identify opportunities to build stronger relationships with their customers.

[1] http://www.clevelandfed.org/research/commentary/2009/0609.cfm#, accessed Sep. 28, 2011.

SUSTAINED DEMAND FOR CHECKS DEMONSTRATES CONTINUED VALUE

Despite oft-repeated projections regarding the demise of paper payments, recent research on the "State of the Check" from Javelin Strategy & Research has confirmed that checks continue to be a central component of the DDA relationship. Although electronic payment options have offset check transaction volume in recent years, scenarios in which checks are not only a viable but also a preferred payment vehicle are identified by consumers, small business owners, and financial institution stakeholders alike.[2] The following discussion evaluates these situations by outlining current check usage and value, the key reasons for using checks, the generational differences in check usage, the value of check users to FIs, and the continuing use of checks by small businesses.

Check volume has decreased but still represents a sizable share of transaction activity. FIs acknowledge a continuing contraction in check payments; most reported decreased check transaction volumes in the high single digits or low double digits year over year. Nonetheless, checks continue to be a primary payment vehicle, and Figure 1 details the persistent use of checks. In 2009, according to a study by the Federal Reserve, 24.5 billion checks were written,[3] accounting for 12.7% of monthly payments and 8.2 transactions per month per consumer.[4] This total volume reflects a decline from the 30.5 billion checks written in 2006, amounting to a negative 7.1% compound annual growth rate (CAGR).[5] However, check payments continue to significantly exceed credit card, ACH, and prepaid card volume, accounting for 22% of noncash payments in 2009. In that year, only debit card volume was more substantial than checks as a share of noncash payments. However, the share represented by debit transactions is subject to shrinkage that may cause a corresponding rise in check transaction share as new components of the Durbin Amendment are implemented in October 2011.

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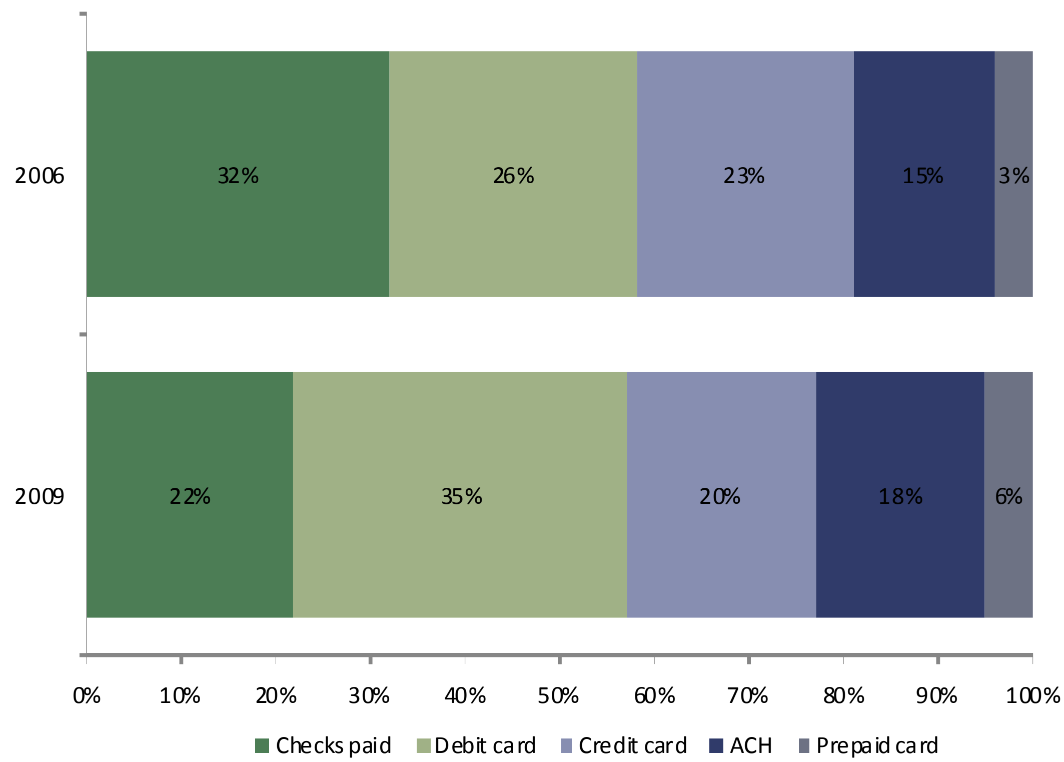
[2] **State of the Check: Consumer Qualitative Report**, Javelin Strategy & Research, June 2011; **State of the Check: Small Business Owners Qualitative Report**, Javelin Strategy & Research, June 2011; **State of the Check: FIs and Vendors Qualitative Report**, Javelin Strategy & Research, June 2011.
[3] 2010 Federal Reserve Payments Study: Noncash Payment Trends in the United States: 2006–2009, Updated Apr. 5, 2011, Federal Reserve System
[4] 2009 Survey of Consumer Payment Choice, http://www.bostonfed.org/economic/ppdp/2011/ppdp1101.pdf, accessed Sep 28, 2011.
[5] 2010 Federal Reserve Payments Study: Noncash Payment Trends in the United States: 2006–2009, Updated Apr. 5, 2011, Federal Reserve System

Checks Rank Second Behind Debit as the Most Widely Used Form of Noncash Payments

Figure 1: U.S. Consumers' Use of Noncash Payment Methods, 2006 and 2009

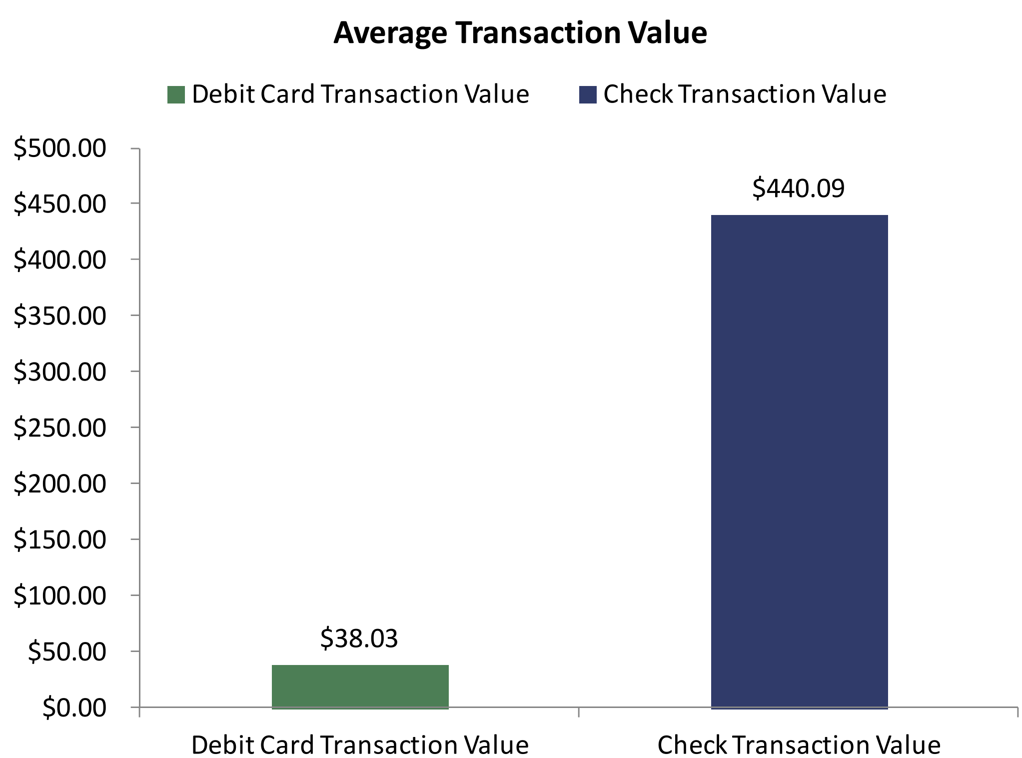


Accessed from: The 2010 Federal Reserve Payments Study
Noncash Payment Trends in the United States: 2006-2009.

Checks take the lead in average transaction value. Although checks trail debit cards in transaction volume, their average value of $440.09[6] per transaction is 10 times greater than the value of an average debit card transaction, as shown in Figure 2.[7] So, for higher-dollar transactions, consumers are not treating debit cards as a substitute for checks. They appear to associate a higher level of importance with check transactions than with debit card transactions.

Checks Still Lead Debit Cards in Transaction Value

Figure 2: Average Debit Card and Check Transaction Values, 2011



Source: Harland Clarke Corp.; Federal Reserve System 12 CFR Part 235, Debit Card Interchange Fees and Routing

[6] Harland Clarke Corp internal study derived from client transactional data.
[7] http://www.federalreserve.gov/aboutthefed/boardmeetings/20110629_REG_II_FR_NOTICE.FINAL_DRAFT.06_22_2011.pdf, accessed Sep. 29, 2011.

Checks continue to offer a wide spectrum of value to consumers. Check writing is routine for most consumers, who use checks largely for bill payments or for personal payments. The "State of the Check" study conducted by Javelin surveyed over 2,000 checking account owners and found that only 2% had never used checks, whereas 78% had used checks in the past 12 months to make some form of payment.[8] Seventy-three percent of consumers who use checks regularly say they pay their bills with them. Although the overall share of checks for personal payments is only 15%, the share is significantly higher among low check users (38%) than heavy check users (11%) for this type of payment.[9] Overall, Javelin found that about 19% of consumers carry paper checks with them at all times and 18% of consumers strongly agree that it would be very hard to make certain payments without checks.[10]

Check usage is driven by individuals' need to be organized, to keep accurate records, to maintain financial control, and to have ease of use. As one consumer respondent noted, "I just use checks so I can have proof that I paid. It is hard to keep up with the little receipts that you get with credit cards. I keep all of my bank statements that I get from the bank. I have them in one binder. It takes me two minutes to go back 3 years in a binder. I've got each month labeled, and you tell me what month I need to go to, and I can go right to it and look to see if I have paid or not."[11] About 68% of the consumers surveyed by Javelin said they use checks because they provide a paper trail and offer greater control than debit cards.[12] One consumer summed this up saying, "With a check you have a paper record, you have control. With the debit card you are just having funds taken out of your account right away."

Some consumers attach emotional value to checks as symbols of financial responsibility and reliability. One consumer explained this by saying, "In my opinion, I think nowadays, because most people … are not getting personal tangible checks, they cannot see how much money they are actually making. They just spend away on their expenses. I think it's kind of like drifting people away from focusing on their finances, and I think they are just losing touch in regard to spending habits." Another consumer noted his predicament saying, "I still need my checks. It is something I cannot let go because I still need them for some purposes. I don't know what we are going to do if we don't have any more checks."[13] Other drivers of check usage include a preference of a recipient of a payment, especially in personal payment situations; avoidance of the hassle of charging small amounts to a credit card; reluctance to pay high fees for use of debit cards; and the payee's habits.[14]

[8] **State of the Check: Consumer Quantitative Report**, Javelin Strategy & Research, July 2011.
[9] Ibid.
[10] Ibid.
[11] **State of the Check: Consumer Qualitative Report**, Javelin Strategy & Research, June 2011.
[12] **State of the Check: Consumer Quantitative Report**, Javelin Strategy & Research, July 2011.
[13] **State of the Check: Consumer Qualitative Report**, Javelin Strategy & Research, June 2011.
[14] Ibid.

Surprising strongholds for paper checks appear in the under-40 population. Javelin's "State of the Check" study found check usage to be primarily associated with females 45 years of age or older and with those having higher incomes.[15] However, populations under 44 years of age still show reasonably strong check-writing habits as well. Javelin's research shows that 41% of individuals between the ages of 18 and 44 write at least one check a month.[16] Although at a median of 7 checks per year, the number of checks written by 18-to 44-year-olds is significantly lower than the median number written by the 45-to 64-year-old age group (26 checks per year), the average dollar value of the checks written is not dramatically different. Among younger users, the average check value is $328, whereas the average value of checks written by those between 45 and 64 years of age is about $380.[17]

The younger population shows a clear current preference for using debit cards (31%) rather than checks (11%). In contrast, the older population of 45+ prefers checks (25%) slightly more than debit cards (17%).[18] The preference of the younger population is likely to change in the near future when FIs implement higher fees for debit card transactions. Notably, Javelin's research predicted a 42% increase in the median number of checks written by this younger population group from 7 to 10 per year over the next two years.[19] The main drivers for check usage by the 18-to 44-year-old age category are the ability to write an unlimited number of checks (34%) and the availability of free paper checks (42%).[20] About one-fourth of the younger population regularly carries checks,[21] indicating that they have the potential to transition into more active check users with relevant marketing messages emphasizing advantages of check usage such as better financial control and ease of use. New service offerings like mobile deposit capture technology will make it easier for younger consumers (as well as those of all age groups) to deposit checks, encouraging heightened payee preference.

Checks users are an asset to FIs. Although many institutions have stopped tracking check-related behaviors, those that continue to monitor check usage have determined that checks are more than a simple payment vehicle; they can also be a sign of a primary account relationship — one that's worthy of attention. Javelin's consumer research also shows a significantly higher asset size associated with check usage. Heavy check users have total assets averaging $240,454 compared to $103,658 among non-users and $182,204 among low-volume check users (those who write between 1 and 13 checks per year).[22] In addition, heavy check users carry a significantly higher average checking balance of $2,829 than non-users' average checking balance of $1,215.[23]

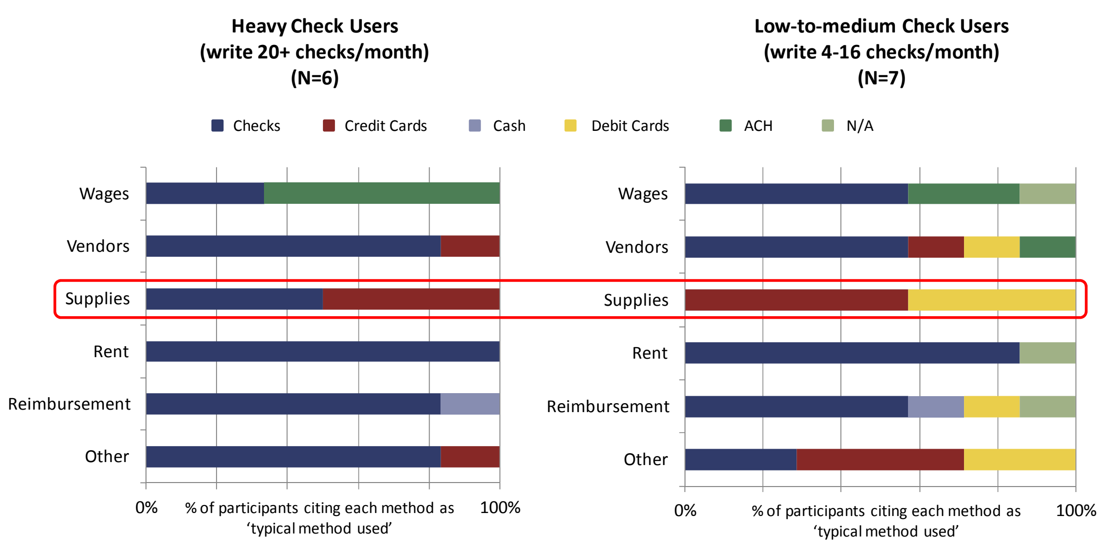
[15] **State of the Check: Consumer Quantitative Report**, Javelin Strategy & Research, July 2011.
[16] Ibid.
[17] Ibid.
[18] Ibid.
[19] Ibid.
[20] Ibid.
[21] Ibid.
[22] Ibid.
[23] Ibid.

Businesses continue to be steady check writers. Along with consumers, small businesses continue to use checks on a regular basis. Javelin discovered that check usage varied among small business owners. While heavier users tend to be companies with annual sales above $500,000, smaller firms that have revenues between $100,000 and $500,000 use checks more moderately.[24]

Among small businesses, certain payments such as payroll, rent, and expense reimbursement continue to be largely check based (see Figure 3). Drivers of check usage for small businesses are tied to vendor preferences to receive payments by check, improved recordkeeping offered in conjunction with checks, and the convenience of paying with or receiving checks. Small business owners note that checks continue to be acceptable in situations where other methods are not feasible, such as for C.O.D. or in-person payments. A plumbing business noted, for example, that its customers most commonly pay by check because they generally do not have credit cards, do not want to pay by card, or do not have enough cash on hand to pay for service. Small business owners also appreciate the paper trail associated with checks. As one owner noted, "Getting a hand signature … on a check … will hold up in court."

Small Businesses Associate Specific Payment Activities with Checks

Figure 3: Payment Methods of Heavy and Low-to-Medium Check Users by Expense Type, 2011



[24] **State of the Check: Small Business Owners**, Javelin Strategy & Research, June 2011.

FUTURE OF CHECKS

Although recent trends reveal a continued decline in check usage, many circumstances remain in which both consumers and businesses see value in using paper checks rather than other payment options. Fully 63% of consumers still use paper checks to pay rent, and about 65% use checks to pay state and federal taxes. Other categories in which paper checks are favored over other modes of payment are medical bills (46%), donations (42%), and services received at home (babysitter, housekeeper, etc.), for which 50% are made via paper check.[25] Consumers and businesses prefer to use checks in such circumstances because of the higher dollar value of these payments and, more important, because using checks gives them better financial control and serves as evidence of payment.

In addition to consumer demand, other industry and regulatory forces at work may spark a renewed interest in paper checks. In response to the Durbin Amendment, FIs may change fee structures that could boost use of paper checks. When consumers are asked about the impact on check usage if a higher credit or debit fee is levied, 48% of low check users said they will write more checks because of these higher fees, and 55% said they will use more checks if a fee is implemented for online bill payment services.[26] FIs have played a role in pushing consumers to debit and credit through the use of reward programs at the expense of other payment types. This practice, combined with the lack of effort on the part of the FIs to provide options to their customers to obtain or reorder checks, has pushed consumers and businesses away from checks. About 42% of consumers indicated that they received starter checks when they opened a new account, but only 26% indicated that a customer service representative asked if they were interested in placing an order for checks.[27] As FIs rethink or eliminate reward programs in the face of Durbin reforms, the incentives for consumers and businesses to use debit is likely to ease, giving credence to paper checks as an alternative.

Advances in check handling and processing technology are also helping checks to retain their value in the payment landscape by driving down cost and creating new conveniences. In the last decade, technologies and practices such as check imaging, remote deposit and mobile deposit capture technology, and check conversion have made checks extremely competitive with electronic payments in processing expense and clearing and settlement timelines.[28] New technology like mobile deposit capture is also removing barriers to check usage by making it easier for consumers and businesses to receive and deposit checks. The role of technology and its impact on sustaining check usage will be discussed in more detail in a forthcoming Javelin whitepaper.

[25] **State of the Check: Consumers Quantitative Report**, Javelin Strategy & Research, August 2011.
[26] Ibid.
[27] Ibid.
[28] **State of the Check: Vendor and FIs Qualitative Report**, Javelin Strategy & Research, August 2011.

CONCLUSION

Even though perceptions of checks and check writing behaviors have changed in the past decade, the check remains an essential payment tool that has demonstrated its durability in consumer and business markets. Both groups identify specific types of payments for which checks are the preferred mechanism, and both groups note critical value proposition factors associated with checks such as documentation, financial control, and broad market utilization and acceptance. At the same time, new technologies, market practices, and changes to the DDA and debit card relationship are repositioning checks as a competitive payment instrument. Therefore, FIs should evaluate the ways checks fit into their customers' overall payment mix and contribute to strong and profitable relationships. It is clear that a transition to completely paperless payments is not viable. However, the check is not dead; instead, it is a meaningful component of a healthy payment and financial servicing relationship.