

PAYMENT INNOVATION: Helping the Underserved

By Sarah Eckstein

Search online for iPhone gadgets and chances are you'll find thousands of applications, or "apps," ranging from maps of hiking trails to a carpenter's level. Most recently, United Services Automobile Association (USAA) became the first financial institution to launch an iPhone application that allows customers to deposit checks into their accounts by capturing a digital image with their phones. The process of scanning and sending a digital image of a check to a bank for deposit, which is called Remote Deposit Capture (RDC), is not new. Although it has been around since 2003, it is likely that new groups of customers will benefit from accessing banking innovation through iPhone applications. This article summarizes new opportunities for reaching regions and markets underserved by the current banking system and the challenges to adopting this new technology.

What is RDC?

Remote Deposit Capture (RDC) is a transaction service that enables a financial institution to receive electronically transmitted deposits from its customers through scanners, and most recently, cellular phones. The image-based technology allows businesses and customers to deposit checks without visiting a bank branch or ATM. In the case of iPhone users, they would use the phone's camera to take photographs of both sides of the check and send the images to their bank. Digital images are transmitted through encrypted Internet connections, which help to prevent fraud. Once the customer's bank receives the image, the bank clears or posts the check to the designated account.¹

In October 2003, Congress passed the Check Clearing for the 21st Century Act, known as Check 21, which allows banks to clear checks from digital images of original checks instead of having to transport the original check back to the paying bank for clearing.² This law is intended to foster innovation in the payment system and to improve the efficiency of check transactions. As a result of the new regulations and other consumer trends, such as the use of debit cards and credit cards, the use of paper checks has declined significantly over the last two decades.³ In 2003, the number of retail electronic payments in the United States exceeded check payments for the first time.⁴

The use of mobile and Internet banking technology has accelerated among customers. Mobile banking connects consumers to financial institutions through their mobile device (e.g., cell phones) to perform self-service banking functions, including monitoring account balances, making payments and transferring funds between accounts.⁵ According to Towergroup consulting firm in an article in *ATM & Debit News*, the number of active U.S. mobile-banking customers will reach 53.1 million in 2013, up from 4.9 million in 2008.⁶ As customers become more technologically savvy with respect to banking services, it is predicted that they will continue to embrace nontraditional banking services that are more convenient and less costly.⁷ Increased growth of subscribers and technological functions in the smartphone industry is also expected to drive expansion of mobile banking. While the Apple iPhone continues to dominate the smartphone industry, Research in Motion's BlackBerry® product has 28.5 million subscribers,

and other telecommunication companies are in the process of launching similar technology.⁸

The Role of Payment Innovations in Serving the Unbanked

For community development practitioners, providing financial services to underserved markets has been an ongoing challenge. Geography, employment, technology and transportation are all challenges that make access to financial services more difficult in some areas. One of the most valuable features of RDC technology is its ability to allow people to deposit checks anywhere. Consumers in rural areas who own a small business or serve in the military often do not have regular access to a branch or an ATM. For these groups, RDC could be particularly beneficial.

Remote access could reduce transportation expenses by eliminating the need to travel to bank branches or ATMs to deposit a check. Customers in rural areas often have to travel a longer distance to a bank branch than their urban counterparts. Driving 20–30 minutes to a bank branch to deposit a check often places additional cost burdens on residents who have to spend more money on gas as well as time away from their jobs or businesses. In addition, banks often offer fewer banking options to less populated communities. As a result, mobile banking increases competition among financial institutions and could drive down service costs for rural customers.

For West Virginia, reaching customers in rural areas continues to be a challenge. West Virginia Credit Union is one of the first in the Fifth District to offer iDeposit, the RDC application for the iPhone. This two-branch credit union has used the technology to reach its members who live outside the Charleston area. The application helps connect individuals in the most remote areas to new financial management opportunities. With just under 14,000 members, only 10 members are currently using the deposit application, but expectations are that the number will increase quickly. Currently, the application will only function for credit union members, but records show the application is being downloaded by nonmembers interested in understanding how the application works.⁹

USAA, the privately owned bank and insurance company that launched the iPhone RDC application, serves many individuals in the military and their families. According to the Department of Defense, military personnel receive orders to relocate to a new assignment on average of once every two to three years.¹⁰ Since many military personnel travel, finding a bank branch or an ATM with national and international coverage can be challenging. USAA reports that military service people typically have to close one bank account and open another account at their new post. Having a longstanding history of responsibly managing a banking account can help consumers receive more favorable loan and credit options. The deposit service would eliminate the need to close and reopen accounts every time a new assignment is given, helping families avoid uninterrupted access to bank accounts and damage to their credit score at a time when access is most critical.

According to the *American Banker*, most large and mid-tier banks offer RDC to their corporate customers but have yet to aggressively pursue small business or individual customers.¹¹ Complex logistics and installation and maintenance costs have deterred banks from supplying RDC services to small businesses. As demand for remote services continues to grow, banks are finding new partnership opportunities among the small business community, especially as infrastructure costs for items, such as scanners and software, decrease.

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For businesses with multiple locations or franchises, having the ability to bank via phone reduces costs. Managing business bank accounts can be difficult with limited bank branch hours. The iPhone check deposit application would allow customers to deposit any time of day from any place. Remote deposit services also accelerate check-clearing. Businesses that capture deposits in their office or processing center offer quicker access to deposited funds and an overall reduction in the time it takes to process checks. Many banks also offer later deposit hours for bank deposits, allowing small business owners the advantage of flexible deposit times.¹²

Other added benefits include the ability of businesses to create a platform for automating all check/receivable processing operations.¹³ In a June 2007 survey of 325 small businesses across a variety of markets, Celent, a research and advisory firm, found checks represent more than 70 percent of receivables among two-thirds of businesses. Remote account receivable services allow for faster fund availability and for fewer personnel needs for handling the manual process, and eliminate added receivable processing fees and courier costs.¹⁴ Checks scanned through the RDC system gain efficiency by reducing account balance errors and the risk of check fraud.

Another advantage for both businesses and banks using RDC is the stronger fraud prevention features that come along with operations. Reports show that banks are experiencing fewer incidences of fraud involving remote-deposit customers.¹⁵ Most financial institutions require customers to go through additional scrutiny before being accepted as an RDC customer. Both banks and businesses mitigate the risk of check fraud through further due diligence of a customer's payment history, assets and credit as if they were underwriting a loan.¹⁶ To further ensure against fraud, technology companies have developed systems and procedures that identify check inconsistencies.

Barriers to Adoption

While the number of smartphone users continues to grow, smartphone costs could limit the number of subscribers. Compared to traditional cell phone subscription plans, smartphone plans can cost significantly more. The smartphones themselves run between \$150 and \$500 depending on whether a contract is activated with the purchase of the phone. Since smartphones act as mini personal computers, they require an additional data service for Internet access. These plans can be upwards of \$100 a month for basic services. The low- and moderate income families that live in rural areas and would benefit from access to RDC have less disposable income to spend on smartphone technology, especially in the current economy.

Unreliable service also presents a challenge for RDC technology reach. According to the USDA, rural land blankets 75 percent of the United States, leaving significant gaps in cell phone reception coverage. Many smartphones operate on a third generation, or 3G, network which allows the transfer of larger amounts of data. In most urban areas, wireless carriers lay third generation (3G) technology on top of existing systems.¹⁷ However, less populated regions still operate on second generation, or 2G, technology which can limit the speed and reliability of the network connection.

New banking innovations are creating opportunities for reaching new and underserved customers. While some technological challenges do exist, such as unreliable cell phone service in rural areas and high subscription plan costs,

significant growth in mobile banking is expected to alter the retail banking industry and spark further financial innovation.

ENDNOTES

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