

Image-Based Check Clearing: A Key to Your Competitive Payments Strategy

Created by the:

CheckImage Collaborative

Raising awareness, promoting the benefits, and encouraging best practices for image exchange and Check 21

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IMPORTANT INFORMATION ABOUT THIS DOCUMENT: The content of this document was prepared by an informal working group of representatives of various financial institutions, trade associations and check clearing houses. This working group is part of a financial services industry effort to consider issues relating to Check 21 and check imaging.

The working group is co-sponsored by the Electronic Check Clearing House Organization (ECCHO) and the Retail Payments Office of the Federal Reserve Bank of Atlanta. The views expressed in this document are not indorsed by, and do not necessarily reflect the views of, the sponsors or the entities that participate in the working group. This document is not intended as legal advice or opinion or any other form of legal or business recommendation to any person. To the extent that the document identifies or discusses a legal matter, a reader or other user of the document should consult with their legal counsel as to its application to them or to a particular situation.

Image-Based Check Clearing: A Key to Your Competitive Payments Strategy

Paper checks provide consumers and businesses a critical alternative payments mechanism. While total volume continues to decline, billions of checks are written and processed each year, and American consumers and businesses remain confident and satisfied with writing checks. However, check processing is experiencing a radical change as financial institutions and their customers now have new, more efficient ways to process and clear checks. Financial institutions need to develop and implement a check image clearing strategy to remain competitive in the future.

Since its implementation in October 2004, the Check Clearing for the 21st Century Act (Check 21) has enabled greater use of imaging technology for check clearing. Because of this law, financial institutions are empowered to convert original paper checks to electronic images for clearing and processing. This provides a faster, more efficient method for check clearing. Each financial institution should consider the benefits of image-based check clearing and include supporting technology investments into their competitive strategy. Financial institutions that continue to exclusively process paper checks will be hindered by geographical barriers and limited customer service improvements and will be subject to unnecessary, anti-competitive overhead costs.

While the move to full check truncation via image exchange will require an initial investment, the payback period is short and long-term benefits are significant. Financial institutions that invest in check image exchange experience the following financial and operational improvements:

1. **Lowered transportation expenses** – Courier costs can be reduced.
2. **Lowered float expenses** – Financial institutions clear checks faster as electronic images than as paper checks.
3. **Improved deposit deadlines** – With broad adoption of check imaging, financial institutions can adjust deposit deadlines to better serve their customers.
4. **Decreased number of processing steps** - Check imaging is a more efficient process that reduces overall cost.
5. **Enhanced customer service** – Streamline processing results in better customer service and opportunities for improved products and services.

Financial institutions must strive toward full check truncation using image technology. This strategy will reduce the costs of check processing amongst all participants. By June 2006, less than two years after Check 21 became

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effective, 24 percent of the industry cleared check images worth \$6.8 trillion instead of moving paper¹.

Paper Checks Remain a Critical Payment Option

Checks remain a significant payment option even though overall volume continues to decline. The *2004 Federal Reserve Payments Study* disclosed three important findings:

1. 45 percent of the non-cash payments made in this country were completed via check (2003).
2. 36.7 billion checks with a total value of \$39.3 trillion were paid (2003).
3. The total number of checks paid between 2000 and 2003 decreased annually by 4.3 percent per year.

The statistics demonstrate that while check volume is in decline, an enormous number of checks are still written and processed. Unlike other payment types, check law restricted the use of technological innovations in check processing until the passage of Check 21. Now with Check 21, the transmission of check images for collection and return is possible. Consumers and businesses will still write checks for decades to come given the benefits of checks. Even with continued volume declines, given the massive size of the check payment system and the continued value afforded to customers and financial institutions, checks will be a key payment method for many years.

The Benefits of Check Image Exchange

As costs to process and transport paper checks rise, all financial institutions need to understand the dynamics of paper-based check processing and to implement image based clearing solutions. Image based clearing is now at the forefront due to the passage and implementation of Check 21. Check images can originate at either a customer or bank location.

Financial institutions must competitively respond to these industry changes. This response should begin with an assessment of the costs and risks associated with continued paper check processing, and consider factors such as:

1. Increased costs including clearing fees, infrastructure expenses, transportation costs and float impacts.

¹ References to the percentage of the industry sending check images were obtained from the CheckImage Collaborative Communications workgroup study. See the full report on images and substitute checks at <http://www.checkimagecentral.org/industryadoptionupdates/>

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2. Geographical barriers that remain between processing locations and branches.
3. Loss of existing and potential new customers due to the competitive edge gained by competitors that effectively clear all items electronically and offer enhanced customer services.

Check image exchange reaps financial institutions a number of benefits:

1. **Improved Clearing Times** -- *Checks enter the clearing process faster as electronic images since physical transportation to a processing location is eliminated.*
2. **Reduced Expenses** – *Check electronification eliminates the need and associated expenses of transporting paper checks to processing sites and clearing houses. Additionally, float expenses can be diminished since there will no longer be collection delays caused by transportation or weather-related problems.*
3. **Reduced Overhead** – *Without paper checks to process, many overhead or infrastructure expenses -- processing costs, human resource expenses, and equipment expenses – are eliminated and re-deployed.*
4. **Diminished Fraud Exposure** - *Faster clearing times will help financial institutions reduce exposure to fraud.*
5. **Expanded Service** - *The potential extension of deposit deadlines provides customers with better service and improved funds availability.*
6. **Enhanced Error Resolution** - *Processing problems, both with individual deposits or in full-scale contingency situations, can be addressed, as images can be forwarded or restored at another location.*
7. **Improved Customer Acquisition/Retention** -. *A financial institution that does not offer remote data capture or enhanced image based products /services could lose business to their competitors, potentially risking their revenue and customer base.*

Implementing Check Image Exchange

Financial institutions are adopting check image exchange at an unprecedented rate. Less than two years after the implementation of the Check 21 Act, 24

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percent of the industry was sending check images instead of moving paper². Institutions that hesitate are at a competitive disadvantage.

Trade organizations, service providers, vendor and consultants are helpful resources for financial institutions developing check image exchange strategies. Once the technology is in place, organizations must work to educate customers, and if necessary, change their behavior to enable the move toward image exchange. This includes explaining long-term benefits and addressing concerns and misconceptions with a focus on:

1. Increased customer confidence in and dependence on convenient check image exchange
2. Improved payments options and services for customers
3. Information security technology and consumer legal protections that make image clearing safe and reliable and eliminate the need to process original paper checks

Conclusion

Checks are the largest non-cash payment option in this country today and remain a critical part of the payments system. All financial institutions must prepare for check image exchange and remember the following:

1. The implementation of the Check 21 Act in October 2004 enables movement to a more efficient check payment system through full truncation via image exchange.
2. The cost of processing a paper check is rising dramatically.
3. Declines in paper check volume are making paper check processing more time intensive.
4. Financial institutions that invest in check image clearing ensure an efficient and effective check clearing system for all.
5. NOW is the time for check image exchange. Develop and implement your strategy NOW!!

² References to the percentage of the industry sending check images were obtained from the CheckImage Collaborative Communications workgroup study. See the full report on images and substitute checks at <http://www.checkimagecentral.org/industryadoptionupdates/>