



# Beyond October 28: *Critical Issues to Consider in Your Image Exchange Strategy*

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Faced with declining check volumes and revenues, a majority of banks are looking towards check truncation and image exchange as critical business elements in their mid- to long-term operations strategies. However, as the implementation date for Check 21 draws near, there remains significant debate over how the benefits of this landmark legislation can best be realized.

As is often the case during periods of disruptive change, even the more aggressive players are weighing the benefits of playing early adopter vs. the risks of making significant investments that don't support long-term strategies. While no crystal ball exists to fully anticipate the operational and technology requirements to support image exchange, some key perspectives have begun to emerge in this regard.

Outlined below is a summary of core capabilities that appear fundamental to any long-term exchange strategy.

## Multiple Exchange Models

Given the variety of exchange formats and rules that have been announced by such major players as the Federal Reserve, Viewpointe and SVPCo, it already appears safe to say that no one exchange model is likely to emerge as an industry standard. In fact, as collecting banks become more sophisticated in managing the variables that define clearing efficiency – such as deadlines, cost, partners, etc. – there may even be a need to vary exchange models and partners for a given endpoint by time of day.

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## Image Quality

Image quality controls are imperative in a world where the original checks and microfilm will cease to exist as

the official payment record. Since image quality standards and the associated risks and liabilities remain somewhat ambiguous, banks are wise to play it safe by demanding full-featured and high-performance image quality assurance tools.

For example, banks should be able to customize "confidence thresholds" for a wide range of inspection tasks and vary those parameters by account, dollar range, endpoint and so on. In addition, the technology must support the new class of quality exceptions and image repair functions required specifically to support image exchange. Given the high potential cost of human intervention in the review of image quality suspects, tuning inspection criteria to optimize the level of "false positives" while detecting a high percentage of "real positives" will be the primary challenges banks face.

## An Integrated Image-Enabled Back Office

Banks have quickly come to realize that almost all the benefits of check truncation and image exchange can be neutralized for institutions still dependent on manual exceptions processing. At a minimum, your back office systems need to be image-enabled. Further, functionality specific to the truncation environment and integration with your image exchange platform are going to be essential. Back office systems will require a more sophisticated level of intelligence to deal with new exception situations in this electronic processing environment. For example, to maintain a high level of efficiency, back office applications will be required to prioritize return reasons while accommodating new exception types (NSF is a more efficient return reason than a bad image, if both conditions exist).

## Substitute Check Creation and Processing

Banks have some options for the forward presentment of truncated checks when they do not, or cannot, present a check electronically. They can create substitute checks (also referred to as Image Replacement Documents, or IRDs) and print them internally using an IRD software solution. Or, they can send an image and data file to a third party to accomplish the same thing. Regardless of image-related strategies, all banks need to be in a position to receive and process physical substitute checks.

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Again, analyzing the business case for the different clearing scenarios enables banks to select the least-cost process based on the partner profile, the location of the bank on which the item is being cleared, and other variables. Remember, processing the original paper may still be the least expensive choice compared to printing a substitute check.

Substitute checks will also have a role in the returns process. The cost associated with checks that do not clear (NSF, closed accounts, etc.) can be reduced with the prudent use of substitute checks.

***A well-devised truncation strategy can also help your bank determine how to minimize costs, and identify new revenue opportunities, as your payments system evolves.***

No matter how your bank chooses to handle substitute checks, you will need a solution for finding the most efficient, cost-effective way to process every payment and return. The best image exchange products feature this capability. Moreover, banks that will be creating a high volume of substitute checks will want to make sure that their image exchange software has fully integrated substitute check file creation and authoring features that answer issues such as quality management, ensuring only one copy is printed, and dealing with situations where the original paper is inadvertently reintroduced into the payment stream.

### New Dynamics in Partner Management

In the traditional paper world, there is a well-defined set of information variables that have defined exchange partners. In an image exchange world, there are significant new variables that must be considered, including image cash letter rules and formats, IRD print locations and image vs. IRD deadlines.

It is likely that you will need robust new partner profiling capabilities to support these new data elements. There is also the longer-term likelihood that "least-cost routing" analysis tools will be incorporated to automate clearing scheme definition based on these new variables.

### Resiliency and Business Resumption

Transmissions will fail, CPUs and data centers will have unanticipated failures, images will fail inspection and new fraud approaches will be devised. IRDs and image exchange will bring a whole new breed of technology challenges to the payments world.

Early pilots have given us valuable insights into the new challenges banks can expect. If possible, banks should conduct their own pilot projects and learn from those already performed. By running exchanged images through the entire end-to-end process, they can discover potential 'leaks' in their systems, and fix them before they cause excessive expense and risk exposure.

In addition, a technology partner with significant experience in mission critical processing can be a valuable ally when it comes to these issues. Due to the extensive testing that is part of the development process, coupled with a pilot project, they will already have confronted and solved a majority of the issues related to image exchange.

### More Advanced Indexing and Audit Trail Capabilities

Indexing and audit trail capabilities are now a top-of-mind consideration for banks, since in an environment without paper trails, everything that happens to a substitute check or image must be tracked and recorded, and that information must be easily retrieved. To mitigate risks such as double posting and fraud, banks will need their image exchange solutions to include robust indexing and audit trail features.

### The Coexistence of Paper and Electronics

The coexistence of paper and electronic payments processing environments for the next several years is a complicated and expensive proposition, but a reality nonetheless. Every bank will be required to maintain multiple payments models, including conventional paper processing, ECP with paper to follow, and image exchange with its various derivatives, including substitute checks.

As a result, your image exchange technology partner must demonstrate success in the current payments environment as well as the entire range of processing opportunities enabled by check electrification. A well-devised truncation strategy can also help your bank determine how to minimize costs, and identify new revenue opportunities, as your payments system evolves. ■

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