

## WHITE PAPER

# Reduce Exception Item Processing Costs: New Technology Paves the Way to New Savings

## Executive Summary

The fiscal strength of financial institutions (FIs) has weakened under the stress of multiple economic and industry factors. A mandate to trim costs to reinvigorate their base and maintain profitability into the coming years grows increasingly difficult to fulfill. And, while the electronification of checks has been a step forward on the path of operational efficiency, initially yielding some economic benefit, it does not go far enough to solve the challenging issue of rising preventable exception item processing costs.

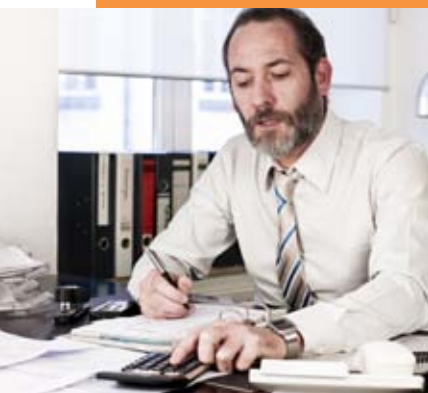
Exception item deposit processing is often a part of internal auditing that singles out abnormal items for further analysis or is directly related to system or process limitations. Any item or transaction that falls outside the boundaries set by the financial institution is removed from the normal workflow and flagged for exception processing. This practice, unique to these items, slows the workflow and invites errors not commonly seen in the majority percentage of the work – lost deposits, missing items, out of balance deposits, missed deadlines, etc.

Efforts to reduce these costs have sought to accelerate a less than optimal procedure. FIs hope to manage the expense by capturing check images in the banking center as early on as possible. Branch and teller capture is a step in the right direction, but results to date have been disappointing. Basic processing errors still frequently become Day 2 adjustment items, and the related operational costs are increasingly more expensive, eating into the upfront savings.



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While the payments system and the consumer and commercial populations have realized efficiencies from check image technology as a whole, the electronification of checks has exacerbated particular operational issues which impede the realization of the full value of image adoption.<sup>4</sup>



### Rethink and retool current deposit processing model

The Federal Reserve and U.S. financial institutions continue to embrace migration to an image based payment system. The benefits are prevalent and indisputable. The industry is still plagued with the most basic of processing errors – the amount difference or simple encoding error. Customers deserve a better if not a bullet-proof solution for eliminating these errors.<sup>1</sup>

Electronification of checks doesn't reduce errors, it simply changes their presentation. With the persistence of keying or encoding errors and the proliferation of new errors such as data mis-match and mis-read images, certain types of preventable adjustments may actually be increasing.

The occurrence and rapid posting of errors in an accelerated image exchange environment negatively impacts FI relationships with customers. Seeing frequent adjustments or – worse, errors needing correction – erodes their confidence and perception of an institution's competency.

While implementing small procedural and technological enhancements has provided modest gains, unless tellers are given new tools that enable them to reduce errors and avoid treating some as exceptions, little more can be gained by adopting this model. A sweeping change to the overall process will ultimately deliver the most meaningful savings – in labor, time, resources and customer satisfaction.

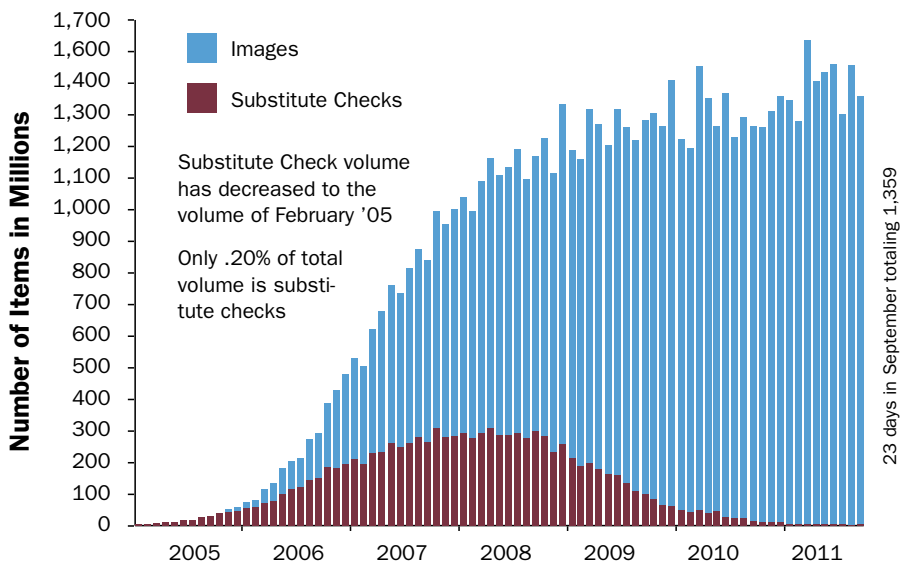
A complete rethinking and retooling of the current model would use faster and more efficient equipment that is integrated with advanced software to provide a complete end-to-end solution. With the right tools, training and partners, vast potential exists for reducing Day 2 exception item volumes and accelerating large deposit processing, and this evolution can be accomplished in any size organization.

### Electronification via check capture is now the industry standard

In a bid to change the collective behavior of FIs, the Federal Reserve has closed all but one paper check processing center and established an all-electronic price list. While they still accept checks, the paper list is cost prohibitive to use. This not-so-subtle encouragement to adopt electronic-only check processing as the preferred standard has persuaded institutions to electronify most, if not their entire processing environment. A Federal Reserve study reported that in 2009:

- 97 percent of “interbank” checks involved electronic clearing (vs. 43 percent in the 2007 study)
- 13 percent of checks were deposited as images at the bank of first deposit<sup>2</sup>

Figure 1 – ECCHO Image Trends September 2011<sup>3</sup>  
Illustrates the dramatic increase in image based transactions over a six year period.



<sup>1</sup> i3G Industry Best Practices Document – Amount Difference Handling  
<sup>2</sup> The 2010 Federal Reserve Payments Study  
<sup>3</sup> ECCHO Check Image Production Statistics  
<sup>4</sup> i3G Industry Best Practices Document – Image Defects: Expediting Image Exchange

## Disappointing check imaging and teller capture results to date

In the migration to branch or teller capture many FIs have merely implemented an electronic version of a paper-based operation that uses multiple processing devices, increases wait times for customers and hinders tellers' ability to accommodate deposits with large numbers of checks. Without proving out the deposit, discrepancies go undetected and a preventable adjustment is created.

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As check imaging and teller capture become accepted practice the prevailing assumption is that the incidence of adjustments will decrease. But the usual "amount difference" processing errors continue unabated, while exception events unique to the electronic environment, such as the posting of duplicate check images, now confront FIs as well.

Examples cited by i3G as typical new exception types include:

- Image quality failure
- Image usability failure
- TIFF standards failure
- Routing and transit numbers ineligible for image conversion
- MICR code line data mismatches

According to i3G, there are three primary negative outcomes that can arise with a disassociation event: warranty problems, privacy breaches, and institutional abandonment, customer dissatisfaction with their financial institution.<sup>4</sup>

Poor quality or unusable images and the new potential claims against the institution they introduce can begin to make electrification seem as if it is creating more headaches than it is eliminating. And, while Check 21 and the subsequent availability of check scanning devices made it possible for images to be deposited by commercial customers, in theory saving FIs time and money, these images are prone to the same inconsistencies and errors as those coming through the branch or teller.

## FIs face slow remote deposit adoption rates as well as rising per-item costs

Making Remote Deposit Capture (RDC) available to businesses essentially allows those customers to pre-process their deposits, reducing the volume of large deposits carried into the facility, and paving the way to all-electronic processing. But the acceptance of check imaging by FIs has far exceeded that of their commercial customers. According to a survey underwritten by J.P Morgan, the typical organization [still] makes 57% of its B2B payments by check.<sup>5</sup> The Federal Reserve, however, estimates that only 13% of checks were deposited remotely in 2009.<sup>6</sup>

Meanwhile, the per-item cost of processing is expected to continue to rise, and preventable Day 2 adjustment or correction items often remain a labor-intensive activity done at the back-counter or back-office. This concerns organizations of all sizes, from branch management levels to executives in the corporate office. All obvious steps are being taken in an effort to better manage this growing concern. Will that be enough?



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<sup>5</sup> AFP Electronic Payments Report of Survey Results

<sup>6</sup> The 2010 Federal Reserve Payments Study



It is time for solutions that go beyond the obvious. This industry needs truly new models to maintain profitability in a changing economy.

### **Teller capture solutions must reduce item correction processing**

Implementing branch capture, migrating to teller capture and making remote deposit capture available to commercial accounts can reduce the handling costs of physical documents to some extent, but none of these strategies resolve the problem of preventable exception adjustments or relieve the time constraints of managing the large deposits that continue to come into the branch.

FIs have reached the tipping point. Choices must be made now to ensure a prosperous, solvent future. Millions of dollars are being spent by FIs in an effort to improve, reduce and/or shorten the cycle of correction processing.

Methods for lowering per-unit cost of correction processing proposed by leaders in the financial community include:

- Avoid duplication of efforts
- Achieve straight-through processing
- Improve distribution of resources across regions
- Remove outmoded methods

More streamlined processing of adjustments is necessary to control rising costs. But there is a need to re-envision the operation as a whole and to create new tools that breathe life into the vision – as well as to mitigate factors that generate exceptions. A lack of ingenuity in many of the tools that technology has promoted as solutions has been particularly disappointing. It is time for solutions that go beyond the obvious. This industry needs truly new models to maintain profitability in a changing economy.

### **Process change + better technology = balanced deposits**

Providers thus far have focused on using check scanner technology and economy-of-scale operations to assist businesses with process improvement. Software and hardware solutions attempt to maximize the efficiency in which check images are obtained, organized, transmitted, retrieved, corrected and/or stored, but all of the tools proposed or implemented to date progressed naturally out of the Check 21 decision.

Cost savings and productivity gains of the magnitude suggested in a September, 2011 McKinsey report<sup>7</sup> require out-of-the-box thinking. For example, cash and checks have historically been viewed as too distinctly different to be processed together. Hence, neither FIs nor providers have promoted a processing environment where these items are scanned and captured by the same device, let alone by a single department. But tremendous operational efficiencies are implicit in the concept of using a single imaging/scanning tool to process and image checks, cash and deposit slips. This capability would represent a great step forward in the race to achieve balanced deposits, and the ultimate solution, “straight-through processing” (STP).

### **Visualize straight-through processing**

Check 21 and the advent of RDC laid the groundwork for STP, but FIs have struggled to nurture the concept from idea to reality. Continuing to manage cash and checks as separate functions has been an obstacle to attaining this ideal. In STP, checks are verified at the point of presentment and transactions credited instantly, as cash is, and funds availability is improved.

A single tool that verifies and reconciles deposit items would alert tellers to questionable input as documents are scanned. They could physically inspect the documents or question the depositor and correct the data before transmitting digitized check images and deposit documents with a cash letter to the clearing system – eliminating the need for costly processing and after-the-fact adjustments, while reducing institutional risk.

<sup>7</sup> In search of a sustainable model for US and European banking, McKinsey, September, 2011

Positioning an image/data integrity process on the outgoing cash letter send side will ensure that all data records are indeed accurate prior to presenting to a paying institution. By doing so, the collecting bank or institution is ensuring warranty for collection.<sup>8</sup>

By redefining the deposit capture process from the point of presentation forward, utilizing technology that brings check, currency and deposit slip processing together, FIs could greatly reduce the number of exceptions and build a new foundation from which to realize their goals.

Financial institutions that are able to identify and correct amount errors prior to posting to their customers' accounts have a competitive advantage with improved customer service.<sup>9</sup>

### **Consolidated processing yields significant savings**

Nothing short of revolutionary, the ability to process, verify and record an entire deposit – using a single machine at the point of presentation – forever alters accepted branch or teller capture practice.

Branches could reduce or eliminate the following costs:

- Post-process errors
- Multi-step deposit processing
- Separate large-deposit processing
- Purchase and maintenance of multiple equipment types
- Document transportation
- Central or outsourced check processing

Customers reap rewards as well:

- Far fewer errors on cash slips/accounts
- Faster moving lines with no added tellers
- Large deposits processed quickly at the teller
- Transactions balanced at the teller
- Customer deposit amounts verified instantly

If the hardware were also a tool that merchants could use to process their checks for RDC, errors in their deposits could be reduced as well – while supporting a much more efficient check processing network. What if their FI could enable them to do all of this?

- Double their check scanning speed
- Maintain a 99.5% accuracy rate
- Process currency as well as checks

Combine lower overall operating costs and a customer service lift with better RDC results – and the ramifications for STP are truly ground breaking. But can these ideals truly be attained?

### **The Cummins Allison solution**

The only devices of their kind, JetScan iFX series check and currency scanners give FIs the ability to produce complete, balanced electronic deposits – to verify and record an entire transaction at any work station in the facility – using one revolutionary machine. The game changing JetScan iFX platform performs advanced processing tasks with unmatched speed, accuracy and reliability, creating a new category of processors and significantly raising the bar in existing categories. State-of-the-art document imaging capabilities are integrated with the fastest, most accurate technology available in a single desktop machine that is designed to process notes, checks and deposit slips.

Cummins Allison offers a unique, patented solution that can enable FIs to:

- Control the rising cost of per item processing
- Lower the high volume of Day 2 adjustment items
- Greatly reduce the incidence of amount difference errors
- Curb disassociation events caused by data/image mis-match
- Prevent errors due to mis-read images from becoming exceptions
- Achieve better customer satisfaction/ minimize account errors

JetScan iFX...  
a single desktop  
machine that is  
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notes, checks and  
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Financial institutions that are able to identify and correct amount errors prior to posting to their customers' accounts have a competitive advantage with improved customer service.

This multi-function processor records high resolution images of both sides of a check and exports MICR line data to check management software. Illegible check amounts or unreadable MICR data is presented for on-the-spot verification.

Out-of-balance transactions are flagged for correction. A complete and balanced electronic transaction record is credited to the account number on the deposit slip – maintaining the integrity of every deposit.

<sup>8</sup> i3G Industry Best Practices Document – Image Integrity

<sup>9</sup> i3G Industry Best Practices Document – Amount Difference Handling

The JetScan iFX i100 is:

- 222% faster than existing desktop check processing products
- 33.4% faster than existing desktop currency processing products
- Up to 99.5% accurate for check and currency processing

The return on investment for FIs is staggering.

- Count, sort and image checks and currency on a single device
  - Up to 1600 notes and 400 checks per minute
- Consolidate functions, eliminate deposit-processing steps
  - Dramatically reduce post-processing costs
  - Accelerate access to funds
- Purchase feature set needed and expand
  - As needs change
  - As new applications develop



The software-based upgradability of these new “future-ready” models is of particular value to end users. Machines need not be replaced simply because the technology has evolved – a software upgrade may be all that is required.

To learn more about how this revolutionary product is changing the face of deposit processing, please visit [cumminsallison.com/iFX](http://cumminsallison.com/iFX)



JetScan iFX i100 received the BankNews 2011 Innovation Solutions Award for Best Equipment Solution.



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## Generations of Vision and Excellence

Cummins Allison sets the standard for accuracy and dependability.

Cummins Allison is a driving force in the money-handling industry, owning more than 350 U.S. patents and inventing note and check imaging and processing technologies that are unique to the industry, faster and more efficient than any competitive product available.

Cummins Allison designs, develops and manufactures high quality solutions for high volume currency and coin processing as well as high-speed currency and check imaging. We employ hundreds of local service technicians across North America to ensure the continued satisfaction of our customers.