



## **Check 21/NACHA: New Opportunities Require New Technologies**

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## Overview

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*The Check Clearing for the 21st Century Act (Check 21) provided for highly efficient check processing and clearing using digital image technology.*

*ECM will permit the realization of operational cost savings from the reduction of paper check processing and allow for newer systems designed to increase the competitive “trade area” of a bank.*

*With ECM, financial institutions can reconfigure their check processing operations, leveraging their existing infrastructures, marketing efforts and core business processes to reduce operating expenses while gaining market share.*

All payments in the United States are governed by two organizations: The Federal Reserve and the National Automated Clearing House Association (NACHA). These organizations set the regulations for the processing and clearing of all payments, both check and electronic. Introduced in October 2004, the Check Clearing for the 21st Century Act (Check 21) provided for highly efficient check processing and clearing using digital image technology. Images of checks can now be electronically passed between banks and accepted for processing and clearing. In those instances where a bank does not yet have image check processing capabilities, an Image Replacement Document (IRD) can be printed and accepted as the original check. NACHA regulations have been developed to also allow the “conversion” of checks received by merchants to Automated Clearing House (ACH) transactions. Both of these regulations have spurred the development and proliferation of systems – at the merchant locations – that are used to capture and “deposit” payments received over the counter, at the register, or in a remittance operation. These systems generate electronic check transactions, both data and (in the case of Check 21) image, which must be received, processed and managed by the financial community. The ever-increasing volume of these transactions places an increased demand on the fundamental check-processing infrastructure at all financial institutions, from clearings to statement processing to customer service.

Enterprise Content Management (ECM) coupled with Business Process Management (BPM) systems provide banks the technology foundation for proactively addressing the impact of rapidly growing Check 21/NACHA transactions. By facilitating a seamless interface to the foundation systems in check processing operations, ECM will seamlessly connect all forms of transactions and allow a rules-based approach to check processing. BPM offers a forward-looking customer service solution that addresses the customer-centric picture of Check 21/NACHA.

### Introduction

With the Check Clearing for the 21st Century Act (Check 21) in October 2004, the US Congress addressed the fundamental regulatory underpinnings to improve the adoption of digital image technology in the check processing operations of financial institutions. In the past, tens of billions of paper checks required costly

and time-consuming transportation for processing. Many of the largest banks have installed image check processing systems and are capable of exchanging image files with other institutions similarly equipped. However, many financial institutions do not, at present, have image check processing capability. Check 21 allows banks to print and present a machine-readable copy of a check, an Image Replacement document (IRD), for forward collection or return to those institutions. These IRDs are legal equivalents of the original check and must be accepted by all financial institutions. By eliminating the need to forward (clear) the original check, banks are saving billions of dollars in transportation, processing and storage costs, while gaining faster access to money.

NACHA has also updated their regulations to permit the conversion of consumer checks to ACH debits at the register (Point of Sale – POS) in a centralized office (Back Office Conversion – BOC) or in remittance processing operations (Accounts Receivable Conversion – ARC).

These regulatory changes have combined to create a rapidly growing market for “remote deposit systems.” To meet this demand, Financial Institutions are installing PC/Web enabled systems in merchant facilities that allow the merchant to electronically deposit checks received on their own premises or “back room.” These systems are highly beneficial to the merchant in that they eliminate all costs of physically going to the bank/branch to deposit receipts, reduce the time for deposit and improve availability of deposited funds.

Banks benefit from these systems in expanding their customer base beyond the traditional geographic branch trade areas and in significantly reducing check processing and clearing costs. However, these systems and the activity from Check 21/NACHA regulations require that traditional check-processing operations be improved to accommodate the ACH/image/IRD clearing activities and supported with customer service and case management systems capable of working with a variety of content.

### **Check Processing Operations**

Traditionally, bank check processing operations were distinct organizational units separate from those that supported electronic transactions (e.g. wire transfers and ACH). With the adoption of image check processing systems as well as Check 21/NACHA activities, these organizational distinctions are melding into a transaction processing community that is responsible for all types of transactional activity. As these distinctions blur and/or are consolidated, the business processes must be restructured and the management of all transactional data be significantly improved. The challenge is to facilitate needed change without impacting existing systems and technology that are extremely sophisticated as well as stable legacy installations.

Clearly, this challenge requires a solution that is process-centric – one that leverages the technology and systems already in place but can enable newer elements to be seamlessly integrated into the operations. The enabling technology is Enterprise Content Management (ECM). ECM's multi-faceted capabilities allow organizations to restructure their business processes while managing all forms of associated content and maintain their investment in legacy systems. The Business Process Management (BPM) solutions that result are the type of solutions that are flexible, changeable and adaptable to the newer and growing forms of non-check transactions brought forth from the Check 21 and NACHA regulations.

ECM-based solutions are designed to give financial institutions a complete picture of information whenever there's a decision to be made. By controlling business processes and the content associated with a particular process, ECM enables financial institutions to achieve the seamless integration of paper and electronic transaction processing and to truly realize the benefits of the Check 21 and NACHA opportunities. By merging process, content and connectivity, ECM-based solutions provide financial institutions the ability to build and sustain transaction processing integration throughout their organizations.

### **Risk Management**

The new opportunities, systems and transactions enabled by Check 21/NACHA regulations introduce new elements of risk into traditional check processing operations. Check 21 grants a MICR-encoded substitute check (Image Replacement Document – IRD) the same legal status as the original check. Therefore, an IRD is a negotiable instrument just like a check. This means that financial institutions that produce IRDs assume new liabilities and associated risks. Check 21 assigns the indemnification and warranty on the reconverting institution, that is, the institution that prints the IRD. Not only does the indemnity cover losses, it also covers costs and expenses, including possible subsequent losses related to the substitute check. Large financial institutions print millions of IRDs worth billions of dollars daily. Processing errors or errors made in printing create significant liability risk. Fraud risk is also present in exactly the same magnitude. Therefore, the implementation of new business methods and systems to accommodate IRD printing and processing must be carefully and seamlessly integrated into operations as well as into the basic research and adjustment activities of all banks.

### **Customer Service**

Check 21/NACHA compliant systems cause the consumer to “see” different types of descriptions on their statements for items paid. Where once a consumer received their canceled checks with their statement or more recently, an image statement, these were always created and rendered with original cashed checks on hand at the bank. The new “remote deposit” systems proliferating as a result of Check 21/NACHA regulations will truncate the check at the merchant and move for clearing either its image, or an IRD, or “convert” the check to an ACH entry that will appear on the statement in the same manner as an ATM or debit card transaction. Often, the consumer will contact the financial institution looking for an item that has been paid. This requires that the customer service area have access to all statements and transactions regardless of data type or method of clearing.

IBM ECM systems link all data types seamlessly to provide customer service representatives with easy access to required data. IBM-enabled customer service solutions are designed to work within an organization's existing customer service system and guide the customer service representative through the steps required to answer customer queries.

### **Dispute Resolution**

In complying with Check 21 dispute resolution requirements, the case management functionality of ECM solutions can increase responsiveness, reduce risk and minimize costs. Case management integrates processes and content from non-integrated bank

systems to provide appropriate stakeholders access to relevant documentation and account data at the click of a mouse. With ECM, the case management process is automated to ensure timely resolution and follow-up. Timers alert service representatives to pending tasks and upcoming deadlines, while managers have a complete view of all work in progress in a variety of report formats. With its strict 10- and 45-day deadlines, Check 21 virtually demands the kind of automated approach to dispute resolution that ECM delivers.

Timing will also play an important role in the service related to dispute resolution. Check 21 includes a provision for addressing problems traceable to the creation of a substitute check (IRD). Whether it is an incorrect charge due to readability or double-debiting caused by processing of both the original and substitute check, banks must ensure that they can provide consumers rapid re-crediting. The onus is on the bank to present the original or substitute check to demonstrate the validity of the debit or re-credit within one day of determining a customer has a valid claim. If the investigation continues, the bank must re-credit up to the first \$2,500 by the 10th business day and the remainder by the 45th business day following the claim if it remains unresolved. To accommodate these requirements effectively, banks must ensure that they have automated business processes in place to efficiently serve customers inconvenienced by the new system. In both of these areas, banks must take a more proactive approach to servicing the customer. To ensure the seamless management of Check 21 procedures, banks must employ new process methodologies that both enhance customer communication and streamline claims management.

### **Enhancing Operations Under Check 21/NACHA**

Check 21/NACHA regulations have made the most significant impact on the world of check processing operations since the invention of magnetic ink (MICR). Financial institutions are now processing transactions that are paper (check), image, IRD and ACH data forms. While paper checks dominate, the volumes of transactions are beginning to shift in ever increasing numbers. This means that operational procedures and processes, that have long been stable, are now required to improve and expand to accommodate the volumes, types and requirements that the regulations have brought. These required changes offer financial institutions the opportunity to enhance their operations to not only accommodate the regulations but also improve efficiency, lower costs and improve customer service.

The key to realizing these benefits is in the application of technologies that permit the continued functionality of critical core systems and link them to newer systems that manage and control the content of operational activity. ECM systems are the fundamental enabling technology that, coupled with BPM systems, will serve to adapt current operations and gain the cost benefits that lie within.

### **The Future of Bank Customer Service**

By automating processes, leveraging rules engines and streamlining case management, Enterprise Content Management (ECM) systems coupled with Business Process Management (BPM) technologies can offer financial institutions an integrated approach to alleviating consumer concerns related to Check 21. As check processing speeds up, banks must take a more interactive and proactive approach to helping customers manage their money. With its ability to link disparate systems, BPM can connect check processing with customer communication to initiate a more mature level of service.

By integrating information from a bank's existing CRM system, ECM offers even more sophisticated service alternatives by providing knowledge workers a deeper perspective of the client relationship. Using this information, BPM can individualize response to customer inquiries based on typical account balances, additional bank products owned or other information. By leveraging automated processes, organizations can achieve these advanced service levels without incurring increased headcount expenses.

In complying with the Check 21 dispute resolution requirements, the case management functionality of BPM solutions can increase responsiveness, reduce risk and minimize costs. Case management integrates processes and ECM from non-integrated bank systems to provide appropriate stakeholders access to relevant documentation and account data at the click of a mouse. With BPM and ECM, the case management process is automated to ensure timely resolution and follow-up. With its strict 10- and 45-day deadlines, Check 21 virtually demands the kind of automated approach to dispute resolution that BPM delivers.

### **Conclusion**

Check 21 and NACHA regulations have given rise to the growing proliferation of "remote deposit" systems that process check transactions at the merchant location and move image files, ACH files as well as Image Replacement Documents (IRDs) created by the depository or clearing bank forward in the clearing process. Implementation of Check 21 and NACHA compliant systems has changed the traditional functions within a financial institution's check processing and related operations. The necessity to process more and different types of non-check transactions and the associated risk inherent with printing IRDs requires business processes and systems that link core legacy systems to newer processing and customer service operations. Enterprise Content Management (ECM) technology is critical for seamlessly linking these diverse systems and for creating the foundation for Business Process Management (BPM) systems to follow.

ECM will permit the realization of operational cost savings from the reduction of paper check processing and allow for newer systems designed to increase the competitive "trade area" of a bank. With ECM, financial institutions can reconfigure their check processing operations, leveraging their existing infrastructures, marketing efforts and core business processes to reduce operating expenses while gaining market share. This creates an environment for continuous process improvement, providing the capabilities to make quick, smart and cost-effective decisions at every level of the enterprise. Banks that do not innovate with ECM solutions risk being left behind in the race to remain competitive and profitable.

### **IBM ECM: Industry Leadership**

IBM's fully integrated ECM platform offers Banking and Financial Markets industry solutions for managing content and business processes while connecting these assets with applications and legacy systems across the enterprise. IBM ECM solutions are at work in more than 1300 banking and financial institutions around the world, including 23 or the top 25 banks in the world.



## About IBM ECM

As the clear market leader in Enterprise Content Management (ECM), IBM's ECM solutions help organizations make better decisions, faster by managing content, optimizing business processes and enabling compliance through an integrated information infrastructure. IBM's ECM portfolio delivers a broad set of capabilities and solutions that integrate with existing information systems to help organizations drive greater value from their content to solve today's top business challenges. The world's leading organizations rely on IBM enterprise content management to manage their mission-critical business content and processes.

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