

# In-House Item Processing: A Closer Look at the Benefits and Costs

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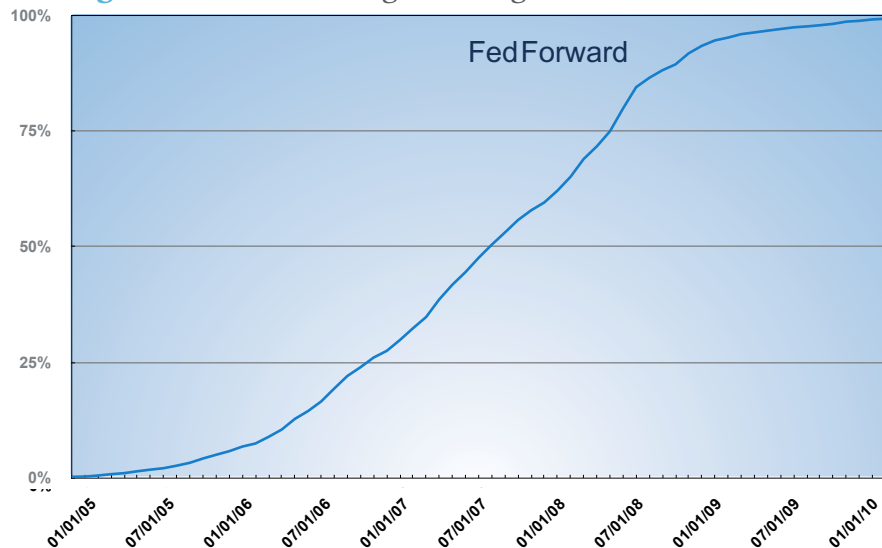
## In-House Item Processing: A Closer Look at the Benefits and Costs

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### INTRODUCTION

Since the introduction of the Check Clearing for the 21st Century Act (Check 21 Act) in 2004, 97 percent of all deposits are now presented electronically (See Figure 1: Check 21 Image Exchange Penetration Trends). The high adoption rate among financial institutions is attributable to both the steadily increasing cost of paper processing and the operational efficiencies gained by switching to image processing. These changes in costs and the benefits inherent to image-based item processing have been well documented. However, can financial institutions derive even greater benefits by bringing item processing in-house?

Figure 1: Check 21 Image Exchange Penetration



\* Source: Federal Reserve Bank, May 2010.

**97%**  
of all deposits  
are now presented  
electronically

While outsourcing remains the most popular choice for item processing among credit unions, there are indications that a wide-spread shift toward in-house solutions is underway. Why are credit unions making this shift? What do they have to gain? What is the process, what are the costs and what are the requirements for moving item processing in-house? This paper presents the results of an in-depth study on item processing based on survey data, case studies, industry trends and interviews with industry experts.

### *In-House Benefits:*

- *cost savings*
- *increased control*
- *greater flexibility*
- *streamlined operations*

## IN-HOUSE VERSUS OUTSOURCING

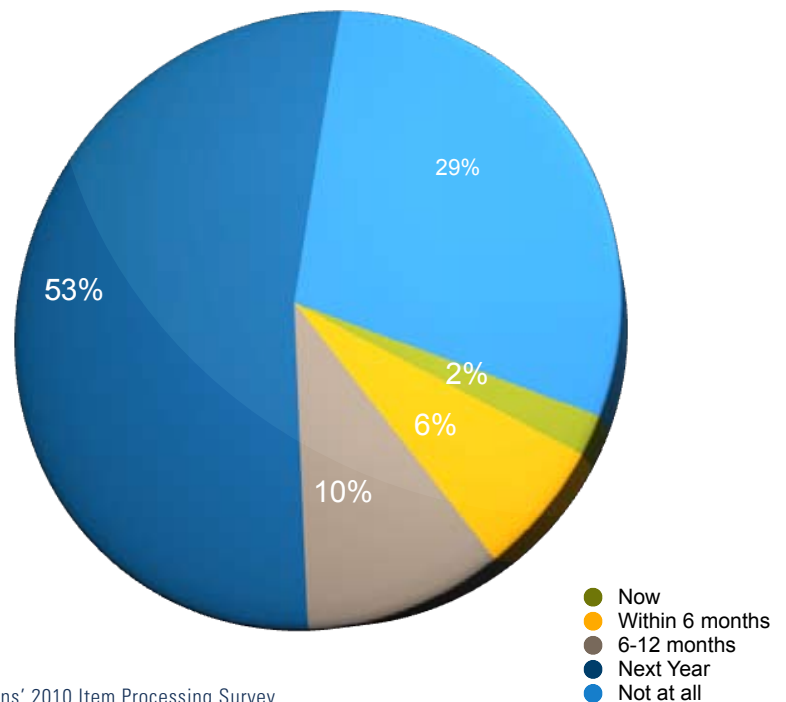
Outsourcing is the most common solution for item processing, but moving in-house offers a unique set of benefits such as cost savings, increased control, greater flexibility and streamlined operations. As their existing outsourcing contracts come due for renewal, it is the combination of these factors that has prompted credit unions to evaluate in-house solutions and compare them with outsourcing options.

**Outsourced Item Processing:** The process of forwarding checks—either paper or images—to a third-party that will process items, transmit them for exchange, act as an intermediary for settlement and maintain an image archive of all items.

**In-House Item Processing:** The process of capturing a visual image of a check and digitally transmitting it for settlement directly to a clearing bank, another financial institution or a third-party image exchange provider. A full image archive is maintained by the responsible financial institution.

*Figure 2: Credit Unions Considering Moving Item Processing In-House*

### Are you currently exploring other options for IP?



\* Source: Bluepoint Solutions' 2010 Item Processing Survey

**87%**  
of surveyed  
institutions  
currently outsource

**71%**  
of those are  
considering moving  
item processing  
in-house by the  
end of next year

The Federal Reserve Bank has increased the cost of paper check processing by **543%** since 2006.

Between March and May, 2010, Bluepoint Solutions conducted an in-depth study of item processing solutions in use by credit unions. The results show that 87 percent of surveyed institutions currently outsource item processing. However, 70 percent of those surveyed are considering moving item processing in-house by the end of next year. *(See Figure 2: Credit Unions Considering Moving Item Processing In-House)* This data indicates that a significant shift from outsourcing to in-house item processing is imminent. This paper explores the context for this shift and the reasons why credit unions are making this switch.

### The Changing Costs of Paper Processing

The Check 21 Act revolutionized item processing by enabling the use of electronic items and cashletters, which has led to the declining use of paper checks. The Federal Reserve Bank (FRB) has increased the cost of paper check processing by 543% since 2006. In contrast, the cost of image check processing has remained relatively unchanged. This trend has forced institutions to adopt image-based item processing in order to stay competitive and cost efficient. The financial institutions that have switched to electronic item capture and presentment have experienced significant operational cost reductions.

### Check 21 as an Enabler of In-House Solutions

Paper check processing is labor intensive. Transporting and sorting paper checks are activities well-suited for outsourcing to providers that can handle enormous volumes and benefit from economies of scale. Once the paper is eliminated, however, so is the need for an outsourcer that handles the physical aspects of paper processing. Distributed capture and workflow automation have shifted most of the labor of check processing onto the institution where checks are captured in the back-office, the branch or at the teller window. Whereas the labor-intensive aspects of item processing were the primary reasons to outsource, the elimination of these activities has now become a major reason to move it in-house. Simply put, outsourcing has become a costly and obsolete methodology.

**Additional staff are unnecessary for a successful in-house implementation since the daily operational tasks are minimal.**

## Implementation Logistics

Additional staff are unnecessary for a successful in-house implementation since the daily operational tasks are minimal. For institutions that are already operating Check 21-enabled branch or teller capture applications, implementing an in-house item processing solution can typically be done by re-directing the image files (X9.37) from the outsourcer to a clearing bank such as the FRB or any other third-party image exchange provider. This requires a relatively small amount of new hardware. The credit union staff currently handling returns can easily process the X9.37 files with the time saved by return automation software that is standard in most Check 21 solutions.

## THE END OF PAPER CHECKS?

In 2004, when the Check 21 Act authorized the substitution of images for paper items, paper checks were submitted to over 40 FRB facilities. Thirty-nine of those facilities have been closed, and of the 700,000,000 items processed daily, only 150,000 of them are presented on paper to the single remaining location in Cleveland. By the end of 2010, the FRB expects to be an “all-exception” paper processing operation, meaning it will only process returns and receipt items on paper. The FRB air courier service, which employed over 300 airplanes to transport paper checks, has been discontinued as a result of the decline in demand for physical check handling .

As the volume of paper items has declined, the FRB has increased the processing cost per paper item, while the cost of processing image items has remained steady or decreased. In 2009 alone, the cost per paper item increased by 50 percent and is projected to continue increasing as the FRB encourages institutions to completely abandon paper.

## Benefits of In-House Item Processing

As image-based processing is increasingly adopted, financial institutions are realizing benefits that were not possible either with paper processing or with outsourced image processing solutions. The major benefits of processing items in-house include:

### 1. Reduced Costs.

By eliminating the middleman, in-house item processing costs are often substantially lower than outsourcing. In a paper-based processing environment, outsourcing delivered economies of scale that do not apply to an image-based environment. Transportation, labor and physical equipment costs—once key considerations for financial institutions—have now been eliminated by Check 21 technology and software automation. Today, the item processing workflow is automated. Courier costs, coding costs and third-party processing fees can be eliminated, providing substantial annual savings. By initiating a direct relationship with image exchange networks, credit unions create an opportunity to avoid maintaining membership capital shares with a corporate credit union, resulting in further potential savings.

### 2. Streamlined Workflow.

Check 21 image capture solutions used by financial institutions offer the opportunity to ensure that every MICR line is correct and every batch of images is in balance before being transmitted for clearing with an electronic cashletter (ECL). The items are also electronically and immediately scrutinized by Courtesy Amount Recognition (CAR), Legal Amount Recognition (LAR) and Image Quality Assurance (IQA) engines at the point of presentment. The result is the delivery of balanced batches of items, requiring no manual correction on up to 85 percent of items. Today, error correction is an entirely automated process, conducted at the branch level, in the back office, or right at the teller line. Both work going out and coming back is “clean” because it has already been balanced and the items all meet check 21 standards for image quality. As a result, financial institutions experience streamlined workflow and greater efficiency with no additional labor costs, making it difficult to justify the cost or necessity of outsourcing. Since all of the errors and corrections work is now done by the software, it is no longer necessary or cost effective to pay outsourcing fees for these same services.

### 3. Increased Control.

An in-house item processing system provides greater control over the release time of items compared with outsourcing. By timing the forward presentment of items to coincide with FRB deadlines, institutions can take advantage of better per item pricing. Better per item pricing means lower overall costs. Financial institutions also gain the most in float. This is amplified by doing forward presentment, inclearings, and returns by image—a practice which provides institutions with the fastest access to item images.

## Benefits of In-House Item Processing (continued)

### 4. Improved Member Service.

By bringing item processing in-house, institutions no longer rely on a third-party for access to archived check images and data. All information is archived and available for real-time retrieval by financial institution employees. As a result, inclearings and returns can be reconciled immediately and account holder requests can be responded to almost instantly. In addition, faster, more efficient transactions and processing times improve employee productivity and enhance service levels to members since they are able to instantly access images of deposited items online.

### 5. Strengthened Fraud Prevention

Bringing item processing in-house creates multiple options for strengthening an institution's fraud prevention measures. Fraudulent items can be caught when deposited check images are aggregated as well as when inclearings are received. Internal fraud prevention measures include MICR validation, CAR/LAR verification, duplicate detection as well as the ability to create an independent "suspect" list maintained by an institution. An in-house solution also has the ability to conduct external fraud checks against 3rd party systems such as Early Warning System.

### 6. Enhanced Risk Management Capabilities.

In-house item processing provides the fastest access to images, giving the institution receiving inclearings more time to make "pay" or "no pay" decisions. It also allows the bank of first deposit to find out very quickly, often within hours, whether there are sufficient funds to clear a check. According to Regulation CC, all items are now local, so only a two-day hold may be placed on most deposited items before clearing them. With a window of only two days to clear a check, in-house item processing enhances a financial institution's ability to manage risk.

### 7. Increased Flexibility.

In-house item processing provides financial institutions with greater flexibility to clear items through multiple endpoints, resulting in the lowest possible per-item clearing cost. With an in-house system, financial institutions have the flexibility to clear items directly with another institution, the Federal Reserve or other third-party image exchange providers such as SVPCO and Viewpointe. OnWe networks can be created by CUSOs and Cooperatives or by simply partnering with other financial institutions for direct presentment. These options are non-existent with an outsourcer. Institutions using an in-house system are able to take advantage of the best possible pricing for clearing items, thereby lowering overall costs.

With the automation inherent to processing images, third-party outsourcers add marginal, if any, value to item processing workflow.

## AUTOMATION OF ITEM PROCESSING WORKFLOW

### From Sorters to Servers

In the past, massive machines were needed to read and sort paper items in large batches in order to manage the day-one check and day-two processing cycles. The high purchase price of these machines, the ongoing maintenance expenses and the specially-trained staff required to operate them justified outsourcing, especially for small and medium-sized institutions. In an image-based environment, sorters and specialized employees are replaced by software and servers, processing ECLs with very little human intervention. The initial investment, recurring maintenance fees and ongoing costs associated with a specialized staff are eliminated.

Correcting errors and rejects—a labor-intensive process with paper items—was an important task that outsourcers performed for financial institutions. But today, most financial institutions have implemented Check 21-enabled branch or teller capture solutions that include MICR/CAR/LAR software. This software ensures that a clean batch is created by automatically performing reject re-entry and corrections work on checks before the image files leave the institution. This can eliminate up to 80 percent of manual reject re-entry and correction work. Since outsourcers now receive clean batches of images from financial institutions and no longer perform manual reject and re-entry work (i.e., “dirty” work), these third-parties add only marginal value to this part of the process. “Dirty” work is rapidly disappearing and making outsourcing an unnecessary burden.



## Saint Francis Federal Credit Union

Pictured: *Tom Eaton, CEO*

6600 S Yale Avenue, Suite 101  
Tulsa, OK 74136

Website: [www.sffcutulsa.org](http://www.sffcutulsa.org)

Founded: 1969

Assets: \$35 million

Members: 8,500

Affiliation: Saint Francis Hospital

## CASE STUDY:

### How Saint Francis FCU Implemented Bluepoint Solutions' ImagePoint & the Benefits Derived from In-House Item Processing

Tulsa, Oklahoma-based Saint Francis Federal Credit Union (approximately \$35 million in assets) made the decision to bring its item processing in-house in 1992 to eliminate the expenses and inefficiencies generated from relying on third-party interceptor and settlement relationships. It was at this time that the credit union established a relationship with the Federal Reserve. The Check 21 Act and the advent of image exchange presented the credit union with a critical decision to maintain its paper-based item processing in-house or outsource to a third-party provider, such as a corporate credit union. In 2007, Saint Francis FCU installed a branch-based, Check 21 solution for the forward presentment of items to the Federal Reserve, while continuing to receive incoming paper.

One of Saint Francis FCU's concerns about maintaining an in-house item processing system was having the necessary information technology resources to support the endeavor. "We are a smaller credit union and our IT department basically consists of one person," explained CEO, Tom Eaton. "When we made the decision to maintain our item processing in-house and move to an image exchange environment, we knew finding the right technology partner would be critical. We looked at many options in the market, but ultimately selected Bluepoint's ImagePoint Foundation solution because of the platform's intuitive design, the ease of installation and its proven reputation in the credit union industry."

"The installation process was seamless," continued Eaton. "We were up and running in one day. With limited IT resources, this was crucial. ImagePoint is basically a plug and play design, which makes it ideal for our institution. Additionally, Bluepoint provided one-on-one training for our end-users. This, combined with the intuitive design of the software, enabled our front and back-office staff to easily migrate to and master the new system."

**VITALS:**

System Used :

**ImagePoint  
foundation**

Year implemented :

**2007**

Items Processed:

**15,000  
in-clearing items****12,000  
outbound items  
monthly**

Approximate Savings:

**\$28,500  
yearly**

Since moving to an in-house item processing environment, the credit union has saved approximately \$10,000 per year by eliminating courier costs, \$2,500 per year by eliminating coding costs and an estimated \$16,000 by cutting out third-party processing fees. Additionally, the credit union was not required to maintain membership capital shares with a corporate credit union, resulting in further savings. Plus, Saint Francis FCU realized a return on investment in twelve months, instead of the anticipated eighteen months—six months ahead of schedule.

“The most important benefit to our credit union is the value we’ve been able to provide to our members,” said Eaton. “In addition to passing savings directly on to our members, our transactions and processing times are faster and more efficient. Having everything managed in-house gives us the ability to reconcile returns immediately and to quickly retrieve images and research member requests. We are not reliant on a third-party for information—all of the data is available in real-time to our staff.”

“Looking back, the initial investment we made to manage our item-processing in-house was a wise decision for the credit union,” said Eaton. “Some of our peers viewed this decision as a risky and cumbersome process. Our investment will, in fact, pay dividends well into the future. Bringing item processing in-house is a fairly simple process and does not need to be intimidating. There is no magic involved in running the exchange system—essentially, if you can cut and paste on a PC, you can easily maintain control of your item processing by managing it in-house.”