

# DIGITAL TRANSACTIONS

Trends in the Electronic Exchange of Value



## Figuring Out The Post-Check Future

As they master image exchange, players in the check-processing chain are hatching strategies against the day when the supply of paper finally dries up.

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No time should be lost on items that are already being exchanged electronically. The industry must spend its time on getting more financial institutions to do image exchange, check conversion, and native electronic payments.

## Why Banks Should Combine NACHA And ECCHO

**With the effort to reach 100% check electrification at a critical juncture, the time has come to converge not only the two mechanisms for electronic check transactions, but also the rule-making organizations that govern them, says George F. Thomas.**

**F**inancial institutions are looking at every alternative to take the paper out of the system as quickly as possible. Each day, more and more checks are being converted into automated clearing house transactions or cleared through image exchange. At the same time, the product boundaries between ACH and image clearing are beginning to blur. So why, one could ask, is the leadership of these efforts still housed in two separate and distinct organizations, with very little cooperation between the two?

The rules for ACH are administered by the National Automated Clearing House Association, formed in 1974. The rules for electronic check presentment and image exchange are administered by the 17-year-old Electronic Check Clearing House Organization.

Now, at a critical juncture in the industry's history, these organizations need to be united so their strategies can be properly aligned. Indeed, now is not only the time to converge the two check-electronification products, but also the two organizations that are chartered to provide the leadership to make this happen.

It has been tried before. Over 15 years ago, bankers met with ECCHO management

in Chicago to discuss the possibility of merging ECCHO's ruling-making operations into NACHA's, which had a longer history of providing rules and rule-making support. It seemed like a smart move then, and it is definitely the smart move today.

Recently, market players have already made unofficial efforts in this direction. During the summer of 2006, several large banks joined forces to fill the void left by these two payment organizations and formed the Check-ACH Coalition. The stated goal of the Coalition was to gather a group of check and ACH professionals together to assess the feasibility of integrating the best features of image exchange and the ACH network to speed up the adoption of check truncation and electronic check exchange by developing another alternative to pure image exchange.

### **Key Issues**

Over 60 organizations joined the Coalition and spent the next six months fleshing out the issues and looking for ways to use the ACH rails to exchange and settle payment instructions. The envisioned service relied heavily on an image-on-demand model to supply images to bank



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customers from image archives.

After significant effort, specialized working groups identified a number of major hurdles that made the chances of crafting a solution in the near term extremely remote. Among these hurdles were the following issues:

► First, an industrywide image-on-demand infrastructure that transcends multiple archives—the foundation on which convergence was based—was determined to be too costly to develop. While image-on-demand sounds attractive, technical and security reasons make it an enormously complex thing to build.

For example, to satisfy a bank's customer seeking check images on demand, hundreds or even thousands of financial-institution image archives must be fully integrated to provide a seamless service. What happens if only a handful of banks or centralized archives can provide images on demand, while many others can't? Clearly, service quality would be poor. Customers—as well as banks—are unlikely to tolerate a service that works only some of the time.

► Equally as important, the image archives operated by each institution today were not built to share data with a multitude of institutions. Image archives are internal repositories that would have required significant re-engineering to supply images on demand to many banks.

Also, allowing access to hundreds of institutions and third-party processors raised serious fraud and privacy issues. While those could have been worked out over time, the policies, procedures, and standards would have taken considerable thought and negotiation. And the solution would have taken years to unfold.

► Next, the industry needed to determine which sets of rules should govern a converged system. The worlds of check and ACH operate autonomously under different sets of rules and legal structure. Each is unique and has a significant number

of constituents, including national and regional governing committees.

While there is some overlap, reconciling them is very difficult. The rules for ACH and check have developed over many decades and are primarily focused on Regulation E for ACH and Regulation CC for check. Determining the proper legal structure for this new application would have taken a considerable amount of time.

► Finally, the key question was, who will pay? The integration of image archives represents a significant and unknown cost. Many financial institutions were already reluctant to invest in a proven technology, such as image exchange. Getting them to set aside money for a project without a proven business case would have been very challenging.

### **No Time To Lose**

In January, the Coalition decided not to prolong its efforts, recommending that the industry continue to look at ways to attain 100% check electronic. One recommendation was for check and ACH professionals to drive the payments solutions.

The best method of combining check and ACH professionals to drive the effort is to combine the organizations that bring these professionals together. While this was not a specific recommendation of the Coalition, in my opinion it should have been. In the absence of this combination of—or even cooperation between—the two industry organizations, each is going its own way rather than following this key recommendation of the Coalition and benefiting from its experience.

NACHA is pursuing its own pilot, called Deposited Check Truncation (DCT). The goal of this initiative is to convert or truncate low-value checks and use the ACH to clear and settle the items. Capturing the payee information is a critical component of reducing the number of requests for a copy of the check. Images would be provided on an exception basis within a specified period of time. Consumers

would not have an opportunity to opt out of the process.

Meanwhile, ECCHO is spending a significant amount of time extolling the virtues of check image exchange over check conversion, such as accounts-receivable conversion (ARC), and trying to get the industry to consider moving from ARC back to image exchange.

Instead, no time should be lost on items that are already being exchanged electronically. The industry must spend its time on getting more financial institutions to do image exchange, check conversion, and native electronic payments.

### **Benefits**

Merging NACHA and ECCHO has a number of significant benefits. The combined organization would have:

- A streamlined governance model, a board consisting of payment-system professionals that understand both check and ACH products and have a vision for the end state;
- A comprehensive strategy for the financial industry to manage the decline in checks while increasing the use of electronic payments;
- A stronger organization that will improve management, leadership, promotion, and training to demonstrate the benefits of moving to a paperless environment;
- A lower cost to the industry, as a combined staff and physical infrastructure will reduce the expenses of salaries, rent, legal, conferences, and board meetings.

The industry is primed to make huge strides in taking paper out of the system. It should be led by an organization that has the vision and leadership to move the industry forward in a clear and holistic manner. For this reason, if no other, financial institutions' senior management should set aside the parochial arguments put forth by the organizations' boards or management and merge ECCHO and NACHA as soon as possible. **DT**