RDC Risk Management Best Practices
-A Financial Institution Perspective

Presented By:
John Leekley, Founder & CEO
Ed McLaughlin, Executive Director
RemoteDepositCapture.com

October, 2008
Agenda

- Definitions & Clarifications
- Strategies & Tactics
- RDC Risks & Risk Management
- Measuring the Results
- Planning for the Future

Legal Disclaimer: This is not legal advice. RemoteDepositCapture.com is reporting on observations and experiences while working directly with dozens of solution providers, financial institutions and the various regulatory agencies. For legal advice / guidance, please work with a competent and qualified legal representative.
RDC is a Payments Platform

RDC Applies to a family of related Products & Services most often differentiated by location of check capture.

Consumer RDC: - Already Here with 50,000+ Users!

The term “Remote Deposit Capture” refers to the process of electronically capturing check images and data, transmitting that information for deposit and clearing, and truncating the original paper checks. This definition is evolving to include additional payment types, including Card Payments.
### Check Clearing Options

#### 2 primary ways to clear Checks

<table>
<thead>
<tr>
<th>Clearing Method</th>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
</table>
| Check 21        | • Applies to All Checks  
                  • Can provide faster Availability | • Can be more costly than ACH (IRDs) |
| • Reg CC        |            |               |
| ACH             | • Theory: Inexpensive  
                  • Day 2 Operations | • Applies to only  
                  • “Eligible Items”  
                  • Requires Notification |
| • Reg E         |            |               |

**Converted to an ACH**

**Truncated & Cleared as an Image / IRD**
The Typical RDC Clearing Process

- Corporate Customer
- Processor
- Depository Bank/Credit Union
- Correspondent or Intermediary Bank (optional)

Electronic Deposit → Processor → Depository Bank/Credit Union → Correspondent or Intermediary Bank (optional)

Checks

Graphic courtesy of NetDeposit

Copyright October 2008, Remote Deposit Capture, LLC
Strategy: Market Segmentation

Small Business
- Convenience
- Transportation Expense Reduction

Middle-Market
- Acct. Consolidation
- Processing Cost Reductions
- Convenience
- Transportation Expense Reduction
- Availability Improvements

Large Corporate
- Availability Improvements
- Account Consolidation
- Total Cost Reductions
- Treasury / Cash Management Impacts & Integration
- Convenience

Copyright October 2008, Remote Deposit Capture, LLC
Define by Application
1. Coupon Based Payments
2. Invoice Based Payment
3. Retail Payments - POS (Point of Sale)

Define by Industry
1. Large Corporate & Retail Customers
   1. Multiple Locations
   2. Integration
   3. May require a mix of RDC and ICL
2. Mid Size Corporate & Retail Customers
   1. Similar to large corporate but may be more regional
3. Small Business & Retail
   1. Simple UI
   2. Low cost/No cost scanner
   3. Integration with QuickBooks
   4. 100% self fulfillment
   5. Price sensitive

Define by Point of Capture
1. Lockbox
2. Branch / ATM / Kiosk
3. Desktop / Merchant Capture
4. POS
RDC has impacts throughout the organization.

Financial Institution

• **Systems Impacted**
  – DDA, Float, Billing, Client Information Files, ACH, Returns, etc.

• **Operations Impacted**
  – Check Processing, ACH, Research, Proof, etc.
  – Business Continuity

• **Business Divisions Impacted**
  – Sales, Support, Product Management, Risk

• **Financials Impacted**
  – Fee Income
  – Float
  – Deposit Balances, Capital Base, Liquidity, Loans

• **Products Impacted:**
  – DDA, Deposits, ACH, Online Banking, and more.

• **RDC requires an organization-wide collaborative effort**

• **Deposit Products Product Management should lead.**
<table>
<thead>
<tr>
<th>Area</th>
</tr>
</thead>
<tbody>
<tr>
<td>Project Management Office (PMO)</td>
</tr>
<tr>
<td>Product Management</td>
</tr>
<tr>
<td>Cash Management Sales</td>
</tr>
<tr>
<td>IT - Application Development</td>
</tr>
<tr>
<td>IT - Infrastructure/Operations</td>
</tr>
<tr>
<td>IT – Security</td>
</tr>
<tr>
<td>Audit</td>
</tr>
<tr>
<td>HR/Training</td>
</tr>
<tr>
<td>Procurement/Vendor Management</td>
</tr>
<tr>
<td>Operations (ACH, Day1, Day 2, Lockbox)</td>
</tr>
<tr>
<td>Risk / Compliance</td>
</tr>
<tr>
<td>Finance &amp; Treasury</td>
</tr>
</tbody>
</table>

Deposits are the “lifeblood” of any financial institution. RDC impacts almost all areas within an FI.

Source; Catalyst Consulting, RemoteDepositCapture.com
RDC Workflow Impacts

• Key Old vs. New Differences
  – Data Management/Process Management
  – Truncated Checks/Source Documents
  – Processing Deadlines
  – Integration & Reporting
  – Float
  – Risk Management

• Ability to re-engineer workflows?
  – How? What? What’s the Impact?
  – Point of Capture
  – Image Cash Letter, ACH, IRD
New Risks With RDC

- Legal Agreements
- Truncated Items
  - Safekeeping, Destruction, Retrieval
- Duplicate Presentment
- System Failure
- Operator Error / Fraud
- Returns
  - NSF, Image Quality
- Vendor Risk Management
Vendor Risk Management

• Deployment Options
  – “In-House”
  – “ASP / Hosted”
  – View Webinar: Hosted vs. In-House Solutions

• Service Level Agreements
  – Processing Timeliness, Bandwidth, Uptime
  – Cutoffs, Reviews, Data Entry
  – Help Desk Roles & Responsibilities

• Security, Accessibility & Reliability
  – SAS 70 Type II Certification
  – Issue Resolution, Reporting
  – Process / System Monitoring & Confirmations
Vendor Risk Management

• Selecting the “Right” Solution Provider
  – Is RDC a Core Capability?
  – Financial Stability
  – Systemic Capabilities
  – Strategic Fit for your organization

• Operational Risk Management
  – Scalability, Reliability & Processing Bandwidth
  – Online access to real-time reports
  – Parameter-driven systems (item thresholds, etc.)
  – Process & System Monitoring Capabilities
RDC – Legal & Risk

• Legal Agreements
  – Risk being pushed to POC Entity
  – Image Quality
  – Duplicates
  – Check Safekeeping
  – Data Security

• Risk
  – Truncated Items
  – Hardware
  – Internet

View Webinar on RDC Legal Agreements, hosted by Paul Carrubba

System Architecture & Functionality can be a critical component of Risk Management
Know Your Customer

Key Information:

- Understand Business
  - Finances, Customers, Processes
- Understand Deposits
  - Obtain History
  - Volumes & Values of Items, deposits, returns,
  - Velocity

RDC Should be customized to each individual client.
Use KYC Data to Manage Risks

- **Client Knowledge**
  - Old: Application, Site visit, etc.
  - New: Client Analytics
    - D&B Report, Choicepoint, Experian, etc.
    - Leverage Online Acct. Opening Process

- **Business Characteristics / Client Monitoring**
  - Deposit Monitoring, Patterning
  - Item, User, Account Thresholds
  - Function Segregation, Approvals

- **Client Agreement**

- **Training, Procedures & Education**
Real Time Risk Management

Parameter Driven Risk Management*

Each deposit should be evaluated in real time across a variety of IQA and negotiability factors to determine whether to accept the deposit and if so what type of funds availability should be assigned.

Parameter Driven Audit Capability**

Customizable via parameters:
- Can audit certain actions (Insert, Delete, etc.) for various objects (Account, Customer etc.)
- Can audit specific operations
  - Login, Password Reset, etc
- Actions

*Courtesy of Ensenta and Star One
**Courtesy of NCR
Duplicate Detection should ideally be done across all levels & accounts, channels and products.

• Levels & Accounts
  – User, Location, Account

• Channels
  – RDC Location, Lockbox, ATM, Branch, Mail Drop, Kiosk & Inclearings, etc.

• Products
  – Check and ACH (for converted items)
Check Safekeeping & Destruction

Education is Critical
- Risks, Legal Agreements
- Periodic Confirmations / Updates

Controls are essential
- Verify items, Encourage your client to audit
- A new service?

Establish Destruction Timelines
- Balance between risk and need for original
- Image Quality / Usability, Returns, Mis-posts
- Observed: 1 Week to 90 days
  - Most seem to fall into 14-60 days
Franking & Endorsements

• Franking? Problematic…
  – Not all items will work with RDC, Must be presented physically
  – Check 21 Legislation — §229.51 General provisions governing substitute checks,
    • A. §229.51(a) Legal Equivalence
    • AAA. 229.2(aaa) Substitute Check Examples.
      "Because information could have been physically added to the image of the front of the original check that appeared on the previous substitute check, the original check image that appears on the front of a subsequent substitute check could contain information in addition to that which appeared on the original check at the time it was truncated”.
  – Technology, system and industry impacts
    – Scanners not capable, will increase cost / deteriorate quality
    – Higher costs mean less use of RDC

• Restrictive Endorsements (on Back of check)
  – Works with current industry practices
  – Helps prevent presentment at teller
  – Leverages current Regulations
Risk Planning and Mitigation Life Cycle

• Assess Risk
  – Customer Selection – Business, Tenure, Transaction
  – History, Balances, Availability
  – Legal Requirements
  – Operations – IT, Networking, Vendor
  – Security – Data, Identity, Network
• Risk Planning
  – Identify Risks Items and Categories
  – Assign Risk Levels
• Mitigation Plans
  – Policies
  – People
  – Processes
  – Technology
• Monitor
  – Policy
  – Operations
  – Security
  – Procedures
• Measure Results
  – Establish Schedule, Standards and Measurement Criteria
  – Automate as many as possible
  – Establish a red, yellow and green system to identify risk exposure
• Report
  – Frequency of Reports
  – Frequency of Reviews
Risk Reporting & Monitoring

• Establish Policies and procedures for RDC that include metrics for reporting and risk tolerances for accounts:
  – Account rules and limits
    • Account Selection – Tenure with Bank, Transaction History, Deposit Balances, Type of Business Assigned Risk rating
    • Deposit limits – per day for review and analysis
    • Item amount limits – Maximum per check
    • Random review of deposits – For accuracy
  – Monitoring and review of accounts for, (aka ACH) for duplicates, rejected and returned items
  – Monitor internal processes for separation of responsibilities: administration for password, account setup, account access, deposit review etc.
  – Establish procedures for regular reporting of deposit history and to identify patterns to more quickly identify deviations in patterns that could indicate problems
  – Periodic emails or letters to customers to remind them of their responsibilities for: check retention, endorsements, adequate safeguards for storage of checks and account information
• Include RDC in internal audit process
Develop a Risk Audit Checklist – Example

- Written RDC Policies and Procedures Document
- Account Selection rules and limits
- Monitoring and review of accounts for duplicates, rejected and returned items
- Monitor internal processes:
  - separation of responsibilities:
  - administration for password, account setup, account access,
  - deposit review authentication and access.
- Establish procedures for regular reporting
  - Deposit history and to identify patterns
  - Periodic emails or letters to customers to remind them of their responsibilities
- RDC included in internal audit process
- Frequency of Security & Internal Audit established
STEP® Knowledge Management

Sustainability
• Ensure organization is continuously fully equipped with the tools to be successful
• Technology, Operations, Guidelines

Training
• Ensure effective, repeated & updated training

Education
• Risks, Value Proposition

Process
• Establish written guidelines, procedures
Recourse is Essential

In the worst-case scenario, how can the FI retrieve funds?

– Availability Schedules
  • Key: Provide availability to account for potential returns based upon Client Risk Profile.

– Required Balances
  • Key: Can enable FI to actually earn more revenues while also providing a reserve against returns.
  • Adds to Deposits, Capital, Liquidity, Loan Capabilities.

– Credit Relationship?
  • Interesting concept, but does not enable FI to have access to funds.
  • Customer already owes FI $$$. 
• **Risk Mitigation**
  - Security – Network, Information, Application & Computer
  - Authorization – authentication, access control
  - Privacy – image integrity and fraud

• **Standards to allow for interoperability**
  - Rules & Formats
  - Shared Databases
  - Aggregated Databases
RDC & Related Technologies can provide better risk management capabilities than were present in a paper-based processing environment.
RDC & Risk – Best Practices

- KYC
- Duplicate Detection
- Deposit Monitoring / Patterning
- Balancing @ POC
- Item / User / Account Thresholds
- Availability Schedules
- Training & Education
- Legal Agreements
RDC Risk Advantages....

RDC Can be a more efficient, safer payments platform than legacy check processing...

• Faster Clearing & Notification of Return Items
• Verification against Negative Databases
• “Forced” Balancing = fewer adjustments
• Deposit Monitoring in greater detail
• Reduced Transportation Risk
• Greater overall automation

RDC is a great advancement for the entire payments industry. Born out of the “Check 21” Legislation, its use should be encouraged.
Next-Generation RDC Technologies

• Architectural Challenges:
  – Client responsiveness
  – UI
  – Parameter-Driven
  – Audit & Reporting
  – Better integration into bank and corporate systems

• Can RDC remain a standalone application?
  – Evolution into a payments platform
  – Inclusion in Vertical Market packages – Medical payments, Property management etc.
Current Trends

- ISOs & Merchant Processors
  - Filling a large unmet need
  - Potential Risk
    - OCC 2008-12 Bulletin

- Consumer RDC (SOHO etc)
  - Hype is overblown
  - Is Risk Real?

- RDC Risk: Overstated?
The Future of RDC....

- Continuous Improvement
- Greater Risk Management
- Process Integration
- Reduced Costs
- Greater Competition
- Segmentation
- Application & Process Convergence
- Corporate Empowerment
- RDC = A Standard Payments Service
- RDC is a Payments Platform

Regardless of the underlying technology, business strategies, competition and clients...

**Quality Execution, Support and Relationship Management will remain Paramount**
Questions?
RemoteDepositCapture.com is an independent information & services resource for the Payments Industry.

– We are NOT a reseller, solution provider, etc.
– We ARE experts in, and an open resource for the industry.
– We work with the vast majority of leading solution providers, FIs, processors.
– Thousands of FIs, corporations, businesses and consumers visit the site each month.
– Services
  • **News & Research**
  • **Community Forums**
  • **RDC Marketplace**
  • **Solution Provider Directories**
  • **RDC Overviews**
  • **White Paper Central**, and more.

• Contacts:
  • [John.Leekley@RemoteDepositCapture.com](mailto:John.Leekley@RemoteDepositCapture.com)
  • [Ed.McLaughlin@RemoteDepositCapture.com](mailto:Ed.McLaughlin@RemoteDepositCapture.com)