

Introduction

Check-21, The Check Processing in the 21st Century Act, was a direct result of two events. Event one had to do with the evolution of check processing technology and the increasing role of technology in financial industry. The second event was the adverse impact on the check clearing network and the nation's transportation system by virtue of 9/11.

Regardless of the events that were the genesis of Check 21, in today's context, Remote Deposit Capture has extended its relevance and utility from what was originally envisioned as an improvement in back office efficiency for most financial institutions to the cell phone millions carry. Looking back from 2003 to the present, the rapid, if not viral, growth of Remote Deposit Capture solutions can be characterized as an unintended consequence of the Act. The proliferation of RDC will accelerate as the cost of processing paper checks continues to increase and the total volume of checks written continues to decrease.

To further reinforce the impact on the financial industry, Remote Deposit Capture has enabled financial institutions to receive imaged deposit documents from anywhere in the world via the internet. Traditional limitations and constraints such as branch locations, state charters and geography have all but been eliminated by Remote Deposit Capture.

The typical framework of deposit processing and customer relationships has been turned upside down since 2003 and there does not seem to be a slowing of creative innovation as it pertains to new and exciting product solutions.

Remote Deposit Capture has grown very fast and in some cases beyond the industry's ability to keep pace, understand and manage the risk associated with technology, hence the Federal Financial Institutions Examination Council's (FFIEC) issuance of guidance related to Remote Deposit Capture.

What is important to note is that in the guidance, the FFIEC focused first on the definition of Remote Deposit Capture as a technology, not just a product, and secondly, on the risks associated with implementing the technology. Key to the understanding of risk is the new doctrine that is introduced in the FFIEC press release titled, *The Essential Elements of Risk*. The challenge is that technology is assuming a greater role in the day-to-day environment of the financial institution. In the past, what was usually relegated to the back office of the institution has moved to every office of a financial institution and beyond. The external customer is now transacting business and making deposits from their office. The conflict and the concern is that the executive suite and board of most financial institutions are moving farther away from understanding the technology their organization is using and making technology decisions without fully understanding the risks.

The FFIEC is very clear in their expectations of financial institutions in regard to how risk is to be managed as it pertains to any form of Remote Deposit Capture technology implemented within the organization. To the surprise of many in the industry, Remote Deposit Capture is not just an automated way for commercial customers (also known as merchant capture) to scan checks and

transmit image files to the institution. It is any form of check scanning technology that an institution decides to implement.

Furthermore, the expectations of the FFIEC are not exclusive to the operations and technology functions of today's financial institution, but reach into the executive suite of the institution and into the board room as well. From the top down, the FFIEC is clear on the role and responsibilities all are to assume in the context of Remote Deposit Capture.

This publication: REMOTE DEPOSIT CAPTURE - RISK MANAGEMENT, will provide your financial institution with a comprehensive view of Remote Deposit Capture as defined by the FFIEC, and the tools needed to successfully implement the RDC technology that meets the specific needs of your financial institution.

The publication is organized into six sections and also includes an appendix that includes the *Check Processing in the 21st Century Act* and the guidance issued by the FFIEC on 1-14-09, *The Risk Management of Remote Deposit Capture* for your reference.

Section One - Risk Management Policy

This section will provide your institution with a comprehensive policy solution needed to comply with FFIEC guidance on RDC. The policy covers all forms of RDC technology, even though your organization may not have implemented them. The policy gives an institution the flexibility to select what applies and move forward. Included in the policy is an explanation of RDC, the technology, expectations of the guidance, imaging policy, RDC strategy, Risk Assessment, Risk Mitigation and Monitoring, required controls and the approval process.

Section Two - Customer Application (Commercial)

The FFIEC RDC guidance is absolute in the requirement of an institution in regard to Knowing Your Customer (KYC) before authorizing the use of RDC. The customer application is not just a form, it is a process. As outlined in the policy, customer suitability is key and completing a thorough due diligence is instrumental. The application is formulated as an extension of the organization's RDC policy. If you follow the steps in the application, your organization will establish a foundation of customer suitability, compliance, and risk management required by the FFIEC. The application can be easily tailored to adapt to the dynamics of each of your customers, while at the same time complying with the organizations policy.

Section Three - Customer Audit, Site Visit and Self Assessment

Prior to approving and implementing a RDC customer, the guidance expects the institution to conduct a site inspection for the purpose of verifying details disclosed in the application, while observing the customer environment. Also required within the guidance are periodical customer audits. This section establishes the criteria and the authority to conduct customer audits, site visits and the self-assessment option (which takes into consideration) that from time to time and based on

unique customer requirements, it is not always practical to conduct the site visit or customer audit. This section provides the scaffolding for an institution to apply as it considers which of the option to use.

Section Four - Customer Agreement (Commercial)

Key to effectively managing risk is educating the customer of their obligations. RDC extends the banking relationship, but at the same time, the RDC activity of scanning (imaging) checks at the customer location and subsequently transmitting a file to the institution for deposit processing occurs outside of the financial institution. Scanning the deposit document, safe keeping and the appropriate destruction of the documents, all of these activities occur outside of the institution's control and purview. The customer agreement defines and details the responsibilities of both parties (the customer and the institution) and outlines the expectations, operating criteria and consequences for non-compliance. The customer agreement, in the same context of the application, threads the entire process together in conjunction with the organization policy and risk mitigation program.

Section Five - Customer Implementation Plan

With any new technology, there can be a myriad of variables that need to be managed and all are contingent on the other. The essential elements of risk doctrine add to the level of complexity as an institution prepares to offer RDC access to the customer. The implementation plan is the combined mechanism of policy, procedures and project plan (check list) that ensures all applicable policies are complied with, the implementation process is uniform and all required steps are completed correctly and properly documented prior to the customer beginning RDC production.

Section Six - Compliance Review and Audit Plan

Every organization needs to have a independent resource (internal or external) to verify that the organization is complying with the internal policies and procedures established and approved by the executive management team and Board of Directors. Be it the compliance department or internal audit, it is paramount that a comprehensive audit program be created to ensure compliance. Time is of the essence and RDC to a large degree is already implemented in many institutions. This section provides the financial institution with an audit plan that conforms to the FFIEC guidance and is adjustable to the range of technology that may or may not be installed.

Section Seven - Customer Agreement (Consumer)

To effectively manage risk, it is essential to educate the customer of their obligations. RDC extends the banking relationship, but at the same time, the RDC activity of scanning (imaging) checks at the customer's home and subsequently transmitting a file to the institution for deposit processing occurs outside of the financial institution. Scanning the deposit document, safe keeping and the appropriate destruction of the documents, all of these activities occur outside of the institution's control and purview. The customer agreement defines and details the responsibilities of both parties (the customer and the institution) and outlines the expectations, operating criteria and consequences for non-compliance. The customer agreement threads the entire process together in conjunction with the organization policy and risk mitigation program.

Appendix I Check Processing in the 21st Century Act (Check 21)

Check Clearing for the 21st Century Act (Check 21 Act). The Check 21 Act was enacted on October 28, 2003, and became effective on October 28, 2004. This section includes a copy of the act.

Appendix II The Risk Management of Remote Deposit Capture (Issued 1-14-09)

This section contains the press release that covers the introduction of the FFIEC guidance on the Risk Management of Remote Deposit and a complete copy of the guidance (with footnotes).