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# IMAGE INDUSTRY BEST PRACTICES DOCUMENT

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## **“IMAGE DEFECTS”: EXPEDITING THROUGH IMAGE EXCHANGE**

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**FOR MORE INFORMATION:  
VISIT [WWW.I3GGROUP.COM](http://WWW.I3GGROUP.COM)**

# i3G: Image Industry Best Practices Document

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IMAGE DEFECTS:  
EXPEDITING IMAGE  
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## EXECUTIVE SUMMARY

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### Electronic Adjustments: Image “Defects”

The Check Clearing Act for the 21st Century (Check 21), enacted by US Congress in 2003, intended to make the US payment system more efficient by encouraging the financial services industry to adopt image based check technologies and electronic processing capabilities (image exchange). While the payments system and the consumer and commercial populations have realized efficiencies from check image technology as a whole, the electronification of checks has exacerbated particular operational issues which impede the realization of the full value of image adoption.

As institutions accelerate the adoption of image cash letters (ICL) in lieu of paper checks for image in-clearings or as a collecting bank, new exception types not found in the collection of paper have emerged. “Image Defects” - items that fail image usability and quality standards fall into this exception category. The lack of common industry practices in dispensation of these items delays financial settlement completion and increases industry payment risk.

**This paper will provide best practices related to optimal processing of “Image Defects” in order to further expedite image check exceptions handling and to reduce the industry’s payment risk.** This recommendation will focus on how to expedite processing of these items, not the root cause of the failure in the first place. The goal is to facilitate movement from a ‘day 2’ adjustment environment to handling ‘day 1’ upon receipt.

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### ELECTRONIC ADJUSTMENTS – “IMAGE DEFECTS”

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The proliferation of check image processing, while quickly adopted, has not been immune from challenges. Traditional “Day 2” check exceptions processing is experiencing new – never encountered before in paper check processing – exception events which slow payment processing due to lack of industry processing standards.

In most cases, these new exceptions are a direct result of capturing institutions not adhering to industry standards for image capture. This creates processing issues downstream for receiving institutions, be it the paying institution or the collecting institution. Typical examples of these new exception types result from:

- Image quality failure (too light/too dark);
- Image usability failure (payment fields are not readable);
- TIFF standards failure (instructions for viewing the image are incomplete or inaccurate);
- Routing and Transit numbers ineligible for image conversion (Routing and transit numbers); or,
- Code line data mismatches (the electronic record does not match the image).

These items all have one thing in common: They are not properly “presented items” and could become warranty claims against the truncating institution.

Typically, these items are rejected in the collection process by either the paying or the collecting institution. **These items are not return items in the typical definition in that they never attempted to pay against the payee account holder.** The items are treated at the paying or an intermediary institution as failing “Check 21” or image presentment warranties. **As these items fail to become paid items there is a need to send the item back expeditiously to the source of the item to mitigate payment risk.**

The lack of standardization in the industry for handling these types of failures in reporting and chargeback of the items adds to payment risk. Confusion exists not only in what to call these new exception types, but in how to handle the financial settlement of the items.

Some institutions reject the items immediately from the processing stream of the ICL, these rejects tend to be known as **“Administrative Returns”, “Administrative Rejects”, “ICL Rejects”, or “ICL Adjustments”**. The items are charged back to presenting source within 1 business day or, in some cases, hours of an ICL being received.

Other institutions, including the Federal Reserve Bank, handle these items through the adjustment process using adjustment codes such as **“Non-Conforming Image”, “Non-Cash Item”, or “Missing Item”** in which the items are handled via the adjustment process subject to the wide range of business days available for clearing adjustment items.

In some cases the item is adjusted to source (defined as the institution the item from which it was received) of receipt, in others cases, to the Bank of First Deposit. This creates delay in placing the item back in the collection stream and additional payment risk if the item is adjusted back to the inappropriate party. Quite often, the issue it is the “intermediary” and not the Bank of First Deposits that creates the exception.

To insure expeditious handling of the item, it is a best practice to charge back to source.

In 2009, ECCHO (Electronic Check Clearing House Organization) updated rules defining several of these reject types as “Administrative Reasons”. For consistency, these items will be referred to as **Administrative Reasons** throughout this document.

In order to minimize interbank collection risk to both the depository and paying institutions for items where the presented check image fails in the processing steam, it is **recommended that these items be charged to source within 1 business day of receipt of the ICL file wherein the item is contained.**

There are multiple ways that institutions are currently reporting these image defects to each other that range from emailing paper reports or spreadsheets, manually entering adjustment data into adjustment systems, electronically loading adjustment data into adjustment systems, or sending electronic ANSI X9.37 data only file formats to source. The speed of which these image defects can be cleared and placed back into the collection stream is directly related to the method in which institutions exchange information.

To insure expeditious handling of these items, the best practice used in direct image exchange between financial institutions is a standard electronic format to notify the source institution of these image defects.

It is recognized that sending or receiving image files from the Federal Reserve results in these error types being classified as NCI (Non Conforming Image) through the adjustment system. Items handled via electronic files exchanged between financial institutions are resolved faster than those which are received through the adjustments channel.

It is the recommendation of i3G to notify the source via the use of an electronic notification in the same format the image file was received.

The ANSI X9.37 file format (and surviving standards) provides for electronic return notification that should be adapted for use for these administrative reasons. **A data only “Administrative Reason” file type such as “ECPD” or “ECPR” should be used to report items failing processing to the source institution. Error codes specific to the cause of the failure must be utilized to insure these items are not processed as a traditional return item, but rather as an item that requires**

**resolution to place back in the collection stream. Utilizing specific fields within the cash letter header information will allow a the institution receiving the electronic notifications of Administrative Reasons to create a separate processing stream for handling the items or to ingest into existing applications and creating a priority handling queue.** Major image clearing networks such as Endpoint Exchange, SVPCO, and Viewpoint support the electronic file format for the exchange of administrative reasons.

The applicable 'defect' or 'return' reasons to be used for electronic data only returns in an "ECPD" or "ECPR" file when Cash Letter Header (Type 10) Returns Indicator (Field 15/14) = 'E' are:

- 'I' Image Missing
- 'Q' Ineligible
- 'U' Unusable Image (Image could not be used for required business purpose e.g. gross image defects, illegible, etc)
- 'V' Image fails security check
- '1' Does not conform to ANS X9.100-181 – 2007 Specification for TIFF Image Format for Image Exchange standard
- '2' Does not conform to the Industry's Universal Companion Document

Institutions receiving these "Administrative Reason" files are typically charged through their settlement accounts for the value of the items. This provides for the ability to prioritize these items in the work stream and creates an impetus for faster resolution to minimize collection risk.

To reduce exposure to collection risk, an institution receiving Administrative Reasons should consider prioritizing these items for same day turn-around to insure the defect is corrected and the item placed back into the collection stream as a properly presented item. Automated feeds to IRD print on demand applications, customer adjustment notices, or into research & adjustment case management systems may be built enabling faster resolution to placing the item back into the collection stream.

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## CONCLUSION

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In summary, i3G recommends the following best practices in handling new, administrative reject exception types:

- 1) Charge back the source of the item (not necessarily the Bank of First Deposit) to insure the entity closest to the image defect directly receives it.
- 2) Chargeback to the source within 1 business day of receipt of the ICL file containing the exception.
- 3) Most expeditious method: Utilize direct image exchange between financial to notify the source institution of these image defects.
- 4) Notify the source via the use of an electronic notification in the same format the image file was received.
  - a. A data only "Administrative Reason" file type such as "ECPD" or "ECPR" should be used to report items failing processing to the source institution.
  - b. Error codes specific to the cause of the failure must be utilized to insure these items are not processed as a traditional return item, but rather as an item that requires resolution to place back in the collection stream

With all of the financial institutions using similar practices that foster the expeditious electronic processing of administrative items, the industry can collectively mitigate payment risk.

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## ABOUT i3G

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The Image Industry Interoperability Group, i3G, is a US financial services industry collaborative formed in 2008 by a small and diverse set of bank organizations with the mission to quickly solve for lingering exceptions and interoperability issues impeding check payment processing efficiencies. The group's goal is to eliminate a large percentage of industry processing exceptions with a few changes to industry operational practices and procedures. I3G members include Bank of America, The Federal Reserve Bank, Frost Bank, JP Morgan Chase & Co, Independent Community Bankers Association (represented by Midwest Independent Bank), Southwest Corporate Federal Credit Union, Sterling Savings, US Bank, and Wells Fargo. More information can be found about i3G and proposed industry solutions by visiting [www.i3gggroup.com](http://www.i3gggroup.com) and [i3G's linkedin group page](#).

Other i3G best practices documents and industry efforts can be found on [www.i3gggroup.com](http://www.i3gggroup.com) include:

- "Dealing with Duplicates" – An industry wide duplicate file notification system
- Bank of First Deposit Electronic Endorsements
- TIFF Tags
- MICR: Interrogating to populate X9.27 Record 25

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## CONTACT INFO

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