ACH Return Items

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One of the many similarities between the ACH system and the check collection system is the process used for returning unposted items to the originator. Financial institutions return ACH items for the same reasons they return checks, primarily insufficient funds. Items may also be returned because an account has been closed, payment has been stopped, no account exists or an item was drawn against uncollected funds.

Just as ACH items may be presented to receiving financial institutions in paper or automated form, dishonored ACH items may be returned as paper items or via automated media such as magnetic tape or data communications. Historically, the vast majority of returns have been processed in paper form. Receiving financial institutions complete preprinted return item forms manually or use computer printed forms. Information contained in the original ACH item must be included on the form along with the reason for return.

Receiving institutions have long had the option of handling returns automatically. Although commercial software packages that create return items from an original ACH input file have been available for some time, few financial institutions chose to use this option or write their own software prior to 1985. One reason is that because of the relatively small number of ACH returns, most institutions could not financially justify the software purchase or development cost necessary to begin automation.

In February 1985, the Federal Reserve System began converting to automated returns all paper returns received at the Federal Reserve Bank of first deposit. Planners determined it would be more cost-effective to automate returns at the Fed of first deposit and allow them to flow through the originating Fed in automated form to the originating financial institution. An important aspect of the Federal Reserve's move to automate returns was the decision to charge a conversion fee to financial institutions returning paper items. The fee was set at a relatively high $2.50 per item. This fee covers the Fed's operating costs to convert the items and provides financial institutions a significant incentive to automate, since automated returns are handled at no fee. Many institutions have since followed this course to save the $2.50 fee.

Recently several private sector companies have begun marketing automated return item packages that allow financial institutions to create an automated return item file using personal computers. Generally, an installation fee and a per item fee (usually lower than the Fed's $2.50 fee) are charged for these return item packages. In addition, many Federal Reserve Banks are now offering personal computer-based programs that allow financial institutions to create automated return item files for transmission to the Fed. Most of these automated return item packages offer economically attractive alternatives to the paper-based return item process.

Not only will automating returns be more efficient from an economic standpoint, but it will also decrease the time needed for a return item to get back to an originating financial institution. In the late 1970s, Chase Manhattan Bank in New York began collecting statistics on ACH return items, including the number of returns, reasons for return, and time between origination and receipt of a return item. When Chase first distributed the results of its analysis, the average length of time for an item to be returned ranged from 10 to 15 days from the date of origination. This was significantly longer than the seven days for a paper item to be returned. Continuing education of receiving financial institutions helped cut the transit period to approximately nine days. The Fed's conversion to automated returns reduced the outstanding time still further, to five or six days, comparing favorably with the time required for a check return.

Occasionally a receiving financial institution must send corrected information about an ACH item back to the originating institution, usually because of an incorrect account number. The corrected information is sent back to the originating institution on a notification form similar to a return item form. Historically those notices flowed back to the originating financial institution in paper form, much like a return item. As with return items, though, financial institutions have the option of sending notifications of change back in automated form. When the Federal Reserve implemented its return item conversion process in February 1985, it included notification-of-change forms. A fee of $2.50 is also charged to convert these notifications from paper to automated form.

The paper ACH return item process is a relatively expensive and slow method of returning unposted items. The Federal Reserve's decision to convert paper to automated media and charge for this service should encourage receiving financial institutions to move toward automation, thus hastening further improvements in ACH efficiency.

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