

customer in the SPOTLIGHT

FEDERAL RESERVE ACH OPERATOR SERVICES

"News from FedACHSM" is the Federal Reserve's nationwide quarterly ACH newsletter reaching over 19,000 ACH participants including banks, savings banks and credit unions. This newsletter is intended for FedACH customers who are interested in seeing ACH fulfill its role as the nation's premier electronic payment service. Share the newsletter. Spread FedACH news.

CONTENTS

Customer in the Spotlight	1
Facts and Figures	2
FedACH DOS to FedLine Web Conversion Continues	2
News Kiosk	3
Questions and Answers	3
What's Coming Up	4

The Financial Services logo, "FedACH," "FedACH International," and "FedLine" are either registered or unregistered trademarks or service marks of the Federal Reserve.

Things that go "POP! POP! POP!" in the Southwest...

And we are not talking about your New Year's Eve celebrations. At First State Bank N.M., headquartered in Albuquerque, New Mexico, they are experiencing an ever-growing number of POP transactions. We talked with Jeanne Vigil of First State Bank N.M. to find out how this FedACH customer successfully grew its ACH volume for point-of-purchase check conversion.

As a result of a well-coordinated partnership with a third-party processor, First State has seen its POP transaction volume grow by more than 175 percent in the last two years. This remarkable success story is the result of a two-step process.



The first step was easy — recognizing the benefits of POP:

- **Increased Efficiency** - Handling electronic "checks" as opposed to the paper kind is proving a money saver for merchants and banks. For starters, processing paper checks through the paper processing system costs about \$3.50 per check, much higher than the cost of an electronic check conversion. Part of the savings results when checks are electronically deposited. Merchants no longer have to fill out deposit slips or travel to the bank to deposit checks.

- **Expedited Collections** - Electronic payments that cannot be paid for reasons such as insufficient funds are discovered and returned far faster than with paper-based systems. That in turn allows the merchants to start the collection process sooner.
- **Reduced Fraud** - Fraud can be detected much more quickly, which will stop bad check writers days before the conventional paper-based methods.
- **No Lost or Stolen Checks** - Electronic checks cannot be lost or stolen before the merchant deposits them.

The second step of the process was simple too... it just took longer to execute. First, Ms. Vigil had to sell the idea of POP to First State's executives. This led to a year of negotiations with XpressChex, the third party merchant processor used to provide ACH origination services. At the time, XpressChex was a pioneer in electronic check conversion, the process of converting a paper check into an electronic transaction at the cash register. First State Bank N.M. was likewise a leader in ACH.

While the volume was light during the first year of the partnership, it has grown steadily since, and First State Bank N.M. sees no limit to the potential for continued growth of POP volume. "I have been in ACH processing for almost 16 years now, and I feel it is the wave of the future," says Jeanne Vigil, commercial services officer at First State. "I have always pushed the envelope for ACH, but now it is moving so fast it's challenging to keep up with."

First State's role in the process, Vigil says, is

(Continued on page 2)

“POP! POP! POP!”

(Continued from page 1)

First State's primary duty is to strip out the returns — consumer transactions that for various reasons could not be completed — and send those to XpressChex. Because of the sheer volume of POP transactions, XpressChex tends to generate more returns than First State's other origination clients, Vigil says. Among the well-known retailers using XpressChex for POP processing through FedACH are a clothing store, an electronics store and a cellular phone company, not to mention countless other retailers.

First State provides ACH origination services for some 400 customers. But XpressChex is the only one facilitating point-of-purchase retail transactions, Vigil says. The others distribute payroll or carry out other non-retail transactions. While other processors like XpressChex have approached First State, Vigil says that most do not meet the bank's stringent credit criteria.

In XpressConversion, a check reader reads the magnetic ink character recognition (MICR) line at the bottom of the check. After the check is fed through the reader and the MICR is captured, the cashier enters the dollar amount using a terminal keypad. From there other things happen very quickly:

- The check is verified against a database. If negative information turns up, the check is rejected.
- If the check is accepted, an authorization slip is printed for the shopper to sign, allowing the paper check to be converted into an electronic transaction. The check is then returned to the consumer stamped “void.”
- The transaction data is electronically transferred through the ACH network that debits the funds directly from the shopper's checking account.
- Settlement is made with the merchant and an ACH credit transaction deposits the purchase amount into the merchant's account.

Information is Power FedACH Services via FedLine Web

Did you know that you can use your FedLine Web certificate to track, research and account for your institution's FedACH activity? FedACH Information Services provide you with the information-gathering capabilities that have always been available to you, but now offer greater functionality and flexibility. Whether you originate and/or receive FedACH transactions or use a third party processor, you can use FedACH Information Services to see your FedACH activity. Five broad categories of FedACH information are available via FedLine Web: settlement information; file, batch and item information; and customer profile information. Information on input to, and output from, FedACH is available for the current day as well as for 10 previous business days.

In addition to information services, FedACH Services via FedLine Web include the ability to derive returns, dishonored returns, contested dishonored returns and notifications of change (NOCs). Returns and

Facts and Figures

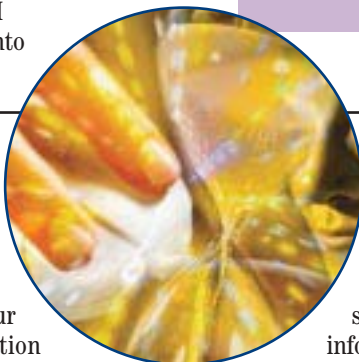
In the past year, FedACH's ARC volume increased by more than 750 percent, exceeding the overall ACH network growth rate for ARC.

Since January 2003, the number of Fed-ACH FedLine Web customers has increased by more than 265 percent.

Through 3Q03, FedACH uptime was 99.93 percent, and 99.99 percent of online transaction files were processed and delivered electronically by the scheduled delivery time.

FedACH customers used FedACH Services via FedLine Web to derive almost 175,000 returns and NOCs in October 2003.

Year-to-date FedACH forward origination volume through October 2003 was nearly 4.8 billion (4.0 billion commercial originations; 0.8 billion government originations).



NOCs can be derived from transactions within 10 previous business days by entering specific search criteria. Subscribers can quickly and easily view a list of Web-derived returns, NOCs, dishonored returns and contested dishonored returns to confirm status information and to drill down to detailed information about selected items.

FedLine Web subscribers have the ability to produce a report that lists returns by originating company for a selected processing date within the 10 previous business days. For each ODFI/originator combination having 50 or more unauthorized returns in a given day, the report lists the number of returns by originator by reason for the following Return Reason Codes: Authorization Revoked by Customer (R07), Customer Advises Not Authorized (R10), and Corporate Customer Advises Not Authorized (R29).

If you are not among the more than 3,000 ACH participants already taking advantage of FedACH Services via FedLine Web, you can learn more about these services at www.frbsservices.org or by calling your Federal Reserve account executive.

Q&A **Understanding ACH Risk**



A few minutes with Richard Oliver, Senior Vice President, Retail Payments Office on the subject of ACH risk.

Q. What is ACH risk? How does it occur?

A. ACH risk can begin with a financial institution's originating ACH credits that would be delivered the next day to many accounts. If that financial institution fails during the day, the ACH credits are no longer funded. Receiving financial institutions that

have paid out funds to account holders may be at risk. Another way that ACH risk can occur has to do with the relatively new types of one-time ACH payments. These payments can be authorized by a consumer over the Internet or the telephone. Some originators (i.e., criminal types) have discovered there are ways to take advantage of these payment types. They, the fraudsters, put through the ACH system unauthorized transactions. When items are refused and returned, the originating financial institution may be at risk for settlement.

Q. You seem to be implying that risk has only recently come to the fore. Is this true?

A. No. I think that there are probably more opportunities for ACH risk problems as a result of the industry moving forward to allow these new single-entry transactions. Both types of transactions have contributed to the growth of the ACH business; however, it appears there are a fair number of fraudsters in those arenas.

Q. As an ACH operator, what is the Federal Reserve doing to mitigate these risks?

A. Many financial institutions today outsource some or all of their ACH origination capability to third parties. We're working with some of those institutions to explore services that would help them monitor debit and credit origination capabilities of third parties. We are also producing daily reports that will show any originating depository financial institution (ODFI) when one of its ACH originators has more than 50 unauthorized returns in a particular day. These reports will give the ODFI the opportunity to detect a company that may have some questionable business practices.

Q. What is the Federal Reserve doing in terms of education surrounding ACH risk?

A. We found that there were people at various levels in organizations making decisions for financial institutions to do business with certain companies or third parties, but not monitoring that business after the fact, or not qualifying the business partner before transactions are initiated.

Q. In conclusion, do you feel like you're keeping pace with ACH risk?

A. Clearly, ACH risk became more significant in the latter part of 2002 and early 2003. Since that time, though, it has been moderating as we've gone about the processes of educating, monitoring, reporting and going after those contributing to abuse of the ACH network.

News *Kiosk*

Accredited ACH Professionals (AAPs)

Following the October 21, 2003 administration of the AAP examination, the number of Federal Reserve staff members holding AAP certificates reached 66. Of these 66 AAPs, 11 received their accreditations after taking the test in October; another seven received reaccreditation through NACHA's continuing education program. We extend our congratulations to everyone who passed this year's AAP exam or was re-accredited this year. The total number of AAPs nationwide increased to an all-time high of 2,334.

Direct Deposit/Direct Payment Promotion

The annual promotional campaign managed by NACHA's ACH marketing management group has concluded for 2003. This year's \$1 million campaign, funded by the ACH operators, included placement of radio and print advertising in numerous markets across the country. Some of the places you may have seen or heard the Direct Deposit/Direct Payment advertisements include radio (NFL Football, NBC News Radio); Sunday newspaper magazines (New York Times, Boston Globe, Los Angeles Times); national magazines (*People Magazine*, *Reader's Digest*, *ESPN Magazine*); and metropolitan magazines such as the *Washingtonian*, *Atlanta Magazine*, and *Seattle Magazine*.



Check Conversion Education Coalition (c2ec)

In October 2003, the Check Conversion Education Coalition (c2ec) was formed to address industry concerns of inaccurate and inappropriate perceptions of Accounts Receivable (ARC). The Coalition, composed of representatives from the Federal Reserve, EPN banks, regional payments associations, and businesses, is charged with developing and carrying out a communications plan and tools to be used by organizations speaking to the media. Educational materials targeting all types of payments industry organizations and general information and resources for public, regulatory, political and consumer organizations are included in the plan. The Coalition expects to have materials produced within the first half of 2004.

WHAT'S COMING UP

Happenings and Events from FedACH

NACHA rules changes effective March 12, 2004 (visit www.nacha.org for additional details)

- ⇒ Clarification that the 'excused delay' provision within the ACH Rules is to be used for catastrophic events, and not for normal processing problems
- ⇒ Modify Return Reason Code R12 description to 'Account Sold to Another DFI' to clarify that this Return Reason Code is used to address the sale of a specific account at a branch. Also, the audit requirements in Appendix Eight will include the Check Serial Number Field for Destroyed Check Entries (XCK).

Conferences

Global Electronic Payments — January 20-21, 2004 in London, UK
Payments 2004 — March 21-24, 2004 in Seattle, Washington

Input File Fee Lowered

Effective January 1, 2004, the only change in the FedACH fee structure will be a \$1.25 reduction in the input file processing fee. This 25 percent reduction lowers the fee from \$5.00 to \$3.75 and applies to both large and small files. Other fees remain unchanged.

Origination	
Items in small files	\$0.0030
Items in large files	\$0.0025
Receipt Items	\$0.0025
Addenda Records	\$0.0010
FedLine Web-derived Returns / NOCs	\$0.50
FedPhone-derived Returns / NOCs	\$2.00
Information Extract File Subscription	\$10.00 / RTN / Month
Monthly Account Servicing	\$25.00 / RTN
Monthly FedACH Settlement	\$20.00 / RTN
FedACH International	
Canada Service Item Originated	\$0.039 surcharge

FedACH Customer Service Via 24-Hour Telephone Access

For FedACH Customers in these Districts

Boston (1)
 New York (2)
 Philadelphia (3)
 Cleveland (4)
 Richmond (5)
 Atlanta (6)
 Chicago (7)

Customer Service Site

**Federal Reserve Bank
of Atlanta**
 1000 Peachtree Street, N.E.
 Atlanta, GA 30309-4470
 Toll Free: 866.234.5681
 Local: 404.498.8902

For FedACH Customers in these Districts

St. Louis (8)
 Minneapolis (9)
 Kansas City (10)
 Dallas (11)
 San Francisco (12)

Customer Service Site

**Federal Reserve Bank
of Minneapolis**
 90 Hennepin Avenue
 P.O. Box 291
 Minneapolis, MN 55480-0291
 Toll Free: 888.883.2180
 Local: 612.204.5555



**FEDERAL RESERVE
RETAIL PAYMENTS OFFICE
1000 PEACHTREE STREET, N.E.
ATLANTA, GEORGIA 30309-4470**

RETURN SERVICE REQUESTED

**PRESORTED
FIRST CLASS
U.S. POSTAGE
PAID
ATLANTA, GA
PERMIT NO. 292**