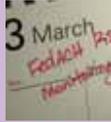


News from FedACH

VOL. 2, NO. 4, DECEMBER 2005

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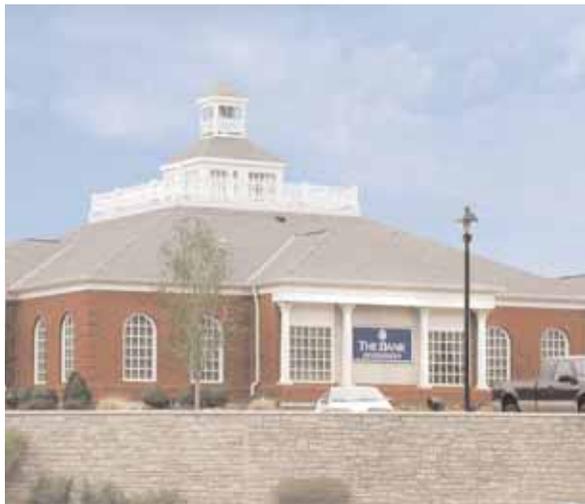
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CUSTOMER IN THE SPOTLIGHT

The Bank of Kentucky

Growing by Knowing Your Customers

Know your customers and grow with them—a simple and straightforward approach to customer service. This philosophy is one key to the success of the Bank of Kentucky as it has grown to become the largest community bank in northern Kentucky. Founded in 1990 and located just south of Cincinnati in Crestview Hills, KY, the Bank of Kentucky is the lead bank for the Bank of Kentucky Financial Corp., a bank holding company with assets of approximately \$950 million. Providing banking and related financial services to both individuals and business customers, the Bank of Kentucky is the fastest-growing bank in northern Kentucky with 27 branches and 41 ATM locations.

One of the newest departments within the bank is Treasury Services. Just a year ago, Jerry Meyer was hired to head up Treasury Services, bringing with him more than 30 years of banking industry experience. Meyer

is responsible for developing products and services to be sold nationally. These include stored value cards, ACH services, consolidated return services, and expansion of the bank's lockbox program.

We recently talked with Meyer, senior vice president of Treasury Management Sales, about the bank's ACH services and products. We wanted to find out more about how this community bank has experienced impressive growth in its ACH business without sacrificing quality or control.

Impressive Growth Defined

Throughout 2004, monthly ACH origination volume at the Bank of Kentucky hovered around 60,000 items. An analysis of 2005 ACH volume through the third quarter revealed that the bank's origination volume had grown by 100 percent over 2004. By late November 2005, that growth rate reached 191 percent. Increases of this magnitude can be attributed

primarily to two types of ACH transactions—direct payments (PPD) and re-presented check entries (RCK). "PPD volume growth stems largely from direct payments originated by a local utility company that followed me to the Bank of Kentucky," Meyer said. Relatively new to the bank is its RCK volume. The bank was already using a consolidated returned check program to meet the needs of large check collection companies, and Meyer recognized the revenue potential associated with taking on RCK volume. Meyer believes this business will continue growing at a steady clip, citing monthly volumes exceeding 60,000 transactions.

Controlling the Risk

Of course, the decision to begin offering a particular ACH service is not one that the Bank of Kentucky takes lightly. During his years of experience in treasury management, Meyer learned that "you have to be very

CUSTOMER IN THE SPOTLIGHT

careful with whom you do business.” As a result, one of his first objectives at the Bank of Kentucky was to develop a robust risk assessment process that relies on coordinated efforts with the ACH operations and credit departments. Simply stated, the bank’s ACH policy “categorically defines the types of customers with whom the bank would or would not do business.” While the types of ACH services and products offered by the bank have expanded during the past year, each decision has been made in light of this ACH policy.

Although the Bank of Kentucky does not currently offer origination services for Internet-initiated (WEB) or telephone-initiated (TEL) entries, Meyer confirmed that, “if the right customer with the right risk parameters came in wanting those services, we would certainly take a look at working with them to make WEB and TEL origination available.”

One recent example of effective risk assessment that the bank performed occurred when a potential consolidated returns customer asked about bringing its point-of-purchase (POP) volume to the bank. Because this was a new customer that was also considered to be a third-party processor, the bank’s ACH policy dictated that due dili-

gence be exercised before taking on this business. While POP volume represents a small percentage of the bank’s ACH business, this type of effort contributes to the ACH network’s historically low-risk performance.

Further recognizing the importance of controlling risk within the ACH network

The Bank of Kentucky’s ACH policy “categorically defines the types of customers with whom the bank would or would not do business.”

and the role that an ODFI can play, the Bank of Kentucky recently licensed a risk monitoring system that will enable it to better monitor its ACH transactions.

More to Come

When asked to project the Bank of Kentucky’s ACH volume, Meyer responded by

saying, “I would be very disappointed if our volumes don’t, on an annual basis, triple for the next several years.” Toward this goal and not wanting to miss out on a proven success, the bank is licensing software that would allow it to offer check conversion solutions to its customers. This software will also be able to handle back-office check conversion if approved. The long-range plan is that, once the software is in place, the bank will have a single system capable of determining which processing path a check needs to follow.

For the Bank of Kentucky, knowing its customers isn’t just an afterthought. As evidence, the bank’s slogan is “You know us, we know you.” With a footprint in a handful of counties, this bank really feels like it is a part of the communities in which it is located. From our perspective, those communities should continue to look for good things from the Bank of Kentucky, a community bank with a footprint that just keeps getting bigger.

Monitoring ACH Origination Risk

Banks Able to Monitor Payments at Batch Level

The Fed’s recently announced ACH risk mitigation service—FedACH RiskSM Origination Monitoring Service—is up and running at select nationwide sites. Eleven depository financial institutions (DFI)—including nine banks and two credit unions—are using features of the service.

This batch-based service tracks, pends, and notifies participating originating depository financial institutions (ODFI) when monitored originators send batches that exceed preset debit and credit caps.

Each ODFI chooses to monitor one or more of its originators or chooses to monitor all ACH activity across the DFI. Caps can be value-based or can be set at zero. For example, an originator may be limited to \$1 million in credit payments and \$500,000 in debit payments per day or across multiple days.

Once a cap is breached, e-mail notifications are sent to participants, who then determine disposition of pended batches.

General availability of the FedACH Risk Origination Monitoring Service is scheduled for March 2006.





- Two FedACH fees will be lowered effective Jan. 3, 2006. The fee for Web-originated returns and NOCs drops from \$0.50 to \$0.30, and the fee for input file processing decreases from \$3.75 to \$2.50 per file. No fees for other FedACH services change. See the back page of this newsletter or visit www.frbsservices.org for a complete listing of 2006 FedACH fees.

- FedACH Services has a new online communication tool: the FedACH Electronic Notification System. This free, subscriber-based e-mail service offers a quick and convenient way for anyone in your institution to stay informed about FedACH processing issues and application outages. If you have not yet registered, visit www.frbatlanta.org/achuser to get started.

- Congratulations to all of you who passed the Accredited ACH Professional (AAP) exam in October. We also applaud those who have put forth the effort to retain and renew their accreditations. If you would like to join the growing number of AAPs nationwide, mark your calendar for the next exam date: Oct. 17, 2006.

- In September, the Directo a MéxicoSM roadshow was launched. Roadshows have been conducted in 16 locations across the country from California to New York and many points in between. Designed to promote the FedACH InternationalSM Mexico Service, each session included meetings with representatives of local financial institutions and Mexican community groups. News coverage of Directo a México has been extensive and positive in both Mexico and the United States. Currently, 58 financial institutions use this service to provide their customers with a better way to send remittances to Mexico. If you would like more information, please contact your local FedACH sales specialist or visit <http://www.frbsservices.org/Retail/intfedach.html>.

FedACH SALES SPECIALISTS

Each of these regional account executives is an ACH resource expert and is dedicated to helping customers find just the right FedACH solution. We encourage you to contact the sales specialist for your district.

Atlanta	Nedelka Bell, AAP	305.471.6472
Boston	Jean Fisher, AAP	617.973.3218
Chicago	Michael Cronkhite	312.322.2145
Cleveland/St. Louis	Susan Bivens, AAP	901.579.2405
Dallas	Matt Davies, AAP	214.922.5259
Kansas City	Joni Hopkins, AAP	620.221.2712
Minneapolis	Marilyn Coleman, AAP	612.204.6964
New York	Thomas Goodman	201.531.3637
Philadelphia	Carol Chartrand, AAP	215.574.3414
Richmond	Della Tate, CTP	410.576.3384
San Francisco	Dorothy Williams, AAP	801.322.7948

ACH RULES CHANGES EFFECTIVE MARCH 17, 2006

The following return reason codes will be modified to address operational efficiency issues as well as to reduce the potential for misuse of certain return reason codes:

- R16 (Account Frozen)**– to clarify use for return of both debit and credit entries
- R27 (Trace Number Error)**– to reflect current practice in which Operators edit to ensure the original entry trace number is included in the addenda record of an NOC entry
- R36 (Return of Improper Credit Entry)**– to include XCK entries returned by an Operator when those entries bear a credit transaction code without the description of ‘reversal’
- R51 (Item is Ineligible . . .)**– require RDFI to obtain a WSUPP from Receiver prior to returning an RCK entry using this code
- R70 (Permissible Return Entry Not Accepted)**– permit ODFI to dishonor an entry returned by RDFI using Return Reason Code R06 (Returned per ODFI’s Request) when ODFI did not request such a return
- R13 (RDFI Not Qualified to Participate)**– clarify that an Operator uses this code to return entries containing a routing number or OGO Identification Number that is not valid for ACH entries

Please visit NACHA’s Web site at www.nacha.org for additional information.

WHAT'S COMING UP

JANUARY 2006

NACHA's Global Electronic Payments Conference
Understanding Market Variables & Opportunities
for Future Success on the International Stage
January 16–17, 2006 Rome, Italy
www.nacha.org

FEBRUARY 2006

Eastpay's Information Interchange 2006
Hitting a Home Run with Electronic Payments
February 12–14, 2006 Orlando, FL
www.eastpay.org

MARCH 2006

**Southern Financial Exchange's
16th Annual Conference and Expo**
Partners in a Secure Payments Future
March 27–29, 2006 Biloxi, MS
www.sfe.org

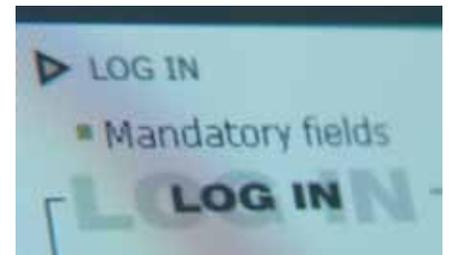
APRIL 2006

WACHA's Electronic Payments Conference 2006
April 10–12, 2006 Green Bay, WI
www.wacha.org

LATEST ENHANCEMENTS TO FedACH SERVICES

Entry Register Now Available to FedLine Advantage Customers

In November, we responded to customer feedback by expanding and improving FedACH Services to provide an even higher level of service at no additional expense to our customers. FedLine Advantage subscribers who send and receive ACH files can now request an easy-to-read Entry Register that provides detail at the item and addenda levels. This register is available online for ACH payment files up to 10 business days old, and the register can also be printed and saved.



Subscribers Define Reporting Threshold for Unauthorized and Invalid Returns

As of December 18, 2005, all customers using FedACH Information Services will enjoy enhanced returns reporting capabilities. While a threshold of 50 invalid or unauthorized returns in a day has been in place since the service's initial availability, customers will now be able to set this threshold as low as one return in a day. In addition, when reporting on a range of days, the resulting reports will accumulate returns volume over the requested time frame. Volumes for specific days will continue to be available as well.

If you have any questions, please contact your local FedACH sales specialist.

CUSTOMER SUPPORT INFORMATION

For FedACH Customers in these Districts

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

Central Operations Support 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)

Central Operations Support 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



We talked recently with Suzanne Howe about the U.S. Treasury's financial transaction processing, focusing on improvements in the Treasury's processing. Howe, who has worked in the electronic payments arena at the Federal Reserve Bank of Cleveland for 16 years, is vice president of Electronic Payments and eGovernment Operations. Working closely with the Department of the Treasury's Financial Management Service, Howe oversees design, development, and implementation of the federal government's check conversion and truncation processing platforms for both over-the-counter and lockbox collections, corresponding settlement systems, and daily operations. She also manages development and operations of ACH settlement for Pay.gov, the Treasury's Internet-based collection system.

Treasury Payments Processing

How do the Federal Reserve Banks factor into the Treasury's payments processing? The Federal Reserve Banks act as fiscal agent for the U.S. Treasury. Several offices provide services to both the Financial Management Service (FMS) and the Bureau of Public Debt.

What payments services does the Cleveland Fed provide to the Treasury? We assist the Treasury with efforts to streamline collections processing, and we manage the electronic check processing system (ECP) for lockbox transactions, the paper check conversion over the counter (PCC OTC) for processing checks collected at agency locations worldwide, and the Pay.gov system for collections across the Web. From an operations perspective, we provide settlement through FedACH and Check 21 for all transactions created by these systems, including representment of items returned for insufficient funds.

Could you give us some examples of these transactions? An ECP transaction would result when an individual mails in a passport application along with a check as payment. The check would be processed and collected through ECP. A PCC OTC transaction would be generated if a deployed soldier cashed a check in the Army Finance Office. Last, a Pay.gov transaction would be generated by a telemarketer paying for the "Do Not Call" list using either a credit card or checking account information.

How does the Treasury benefit from Cleveland's processing solutions? Each processing solution—Pay.gov, ECP, and PCC OTC—supports a single system for a given collection channel. When widely used these solutions save money, simplify research and reporting, and streamline the implementation of mandates, legislative actions, and other government initiatives.

What is the Treasury's approach to check conversion? The Treasury converts all eligible items to ACH to take advantage of reduced costs, additional re-presentments, and streamlined processing.

What conversion issues may be unique to the Treasury? Some unique issues are those experienced at military installations, such as sandstorms affecting payment-related equipment in Afghanistan, network connectivity issues in Turkey, and the challenge of supporting a worldwide customer base. Prior to Check 21, the Treasury converted business checks to ACH under the Treasury's CFR 210 regulation. This practice resulted in high numbers of unauthorized returns. Businesses wanted copies of their checks, and we had to come up with a way to clear these items as checks.

The issue of back-office check conversion is getting a lot of attention. How does the Treasury view back-office conversion (BOC)? In short, the Treasury supports BOC, and Treasury regulations allow BOC in limited circumstances, such as when the processing environment does not support point of purchase (POP), sometimes due to limited electricity or Internet connectivity. With BOC, implementation of Treasury programs is more straightforward and cost-effective.

Where is BOC used? BOC is used at military locations where checks are accepted in militarized zones but cannot be processed at those locations. It is also used in overseas military commissary locations that have checkout lanes that may not have power and Internet connectivity. Checks are scanned and processed in the back office where the necessary resources are accessible.

What do you see as the future direction of the Treasury in terms of check conversion? The Treasury will continue to transition regional settlement processes and operations to a centralized, efficient, all-electronic environment. Recognizing that it cannot be accomplished in all situations, the preferred solution is conversion because it represents the lowest-cost method to settle transactions. The Treasury is closely watching the outcome of NACHA's Back Office Conversion Rules Work Group and the Business Check Work Group in hopes of being able to expand ACH conversion by extending programs throughout the federal government.

FedACH SERVICES PERFORMANCE MEASURES

Year-to-Date through 3rd quarter 2005

Performance Quality Measure

99.89% **Transaction files processed and available timely**

Online transaction files processed and delivered electronically by the scheduled delivery times

99.89% **ACH service availability (uptime)**

Percentage of time FedACH service was available

99.99% **Research and trace requests resolved timely**

Accounting and billing research requests and trace requests concerning ACH items or files responded to within 24 hours

FedACH Volume Statistics	Volume (000)	Dollar Value (000,000)
Commercial Forward Value Items Originated	5,425,878	\$9,519,728
Government Forward Value Items Originated	730,734	\$2,355,479
Commercial Return Items Originated	72,721	\$37,577
Government Return Items Originated	5,300	\$5,920
Total Commercial and Government Non-Value Items Originated (includes NOCs, DNEs, ENRs, prenotes and zero-dollar entries)	76,787	N/A
Total Items Originated	6,311,420	\$11,918,704

2006 FedACH SERVICES FEE SCHEDULE

Origination

Items in small files (fewer than 2,500 items)	\$0.0030
Items in large files (2,500 or more items)	\$0.0025
Receipt Items	\$0.0025
Addenda Records	\$0.0010
Input File Processing	\$2.50 / file
Web-derived Returns / NOCs	\$.30
FedPhone-derived Returns / NOCs	\$2.00
Facsimile Exception Returns/NOCs	\$15.00
Information Extract File Subscription	\$10.00 /RTN /Month
Account Servicing	\$25.00 /RTN /Month
FedACH Settlement	\$20.00 /RTN /Month

FedACH International Services

Item Originated to ¹ :	Canada	\$0.0390
	Mexico	\$0.67
	Austria, Germany, the Netherlands, Switzerland, United Kingdom	\$2.00
Return Received from ² :	Canada	\$0.0390 (surcharge)
	Mexico	\$0.69 (surcharge)
	Austria, the Netherlands, Switzerland	\$5.00 (surcharge)
	Germany, United Kingdom	\$8.00 (surcharge)
	Same day Recall of Item at Receiving Gateway	\$3.50 (Canada only)
	Same day Recall of Item Not at Receiving Gateway	\$5.00 (Canada only)
	Item Trace - Canada Service	\$5.00
	Item Trace - Mexico Service	\$11.50

¹ Per-item surcharge is in addition to standard domestic Origination and Input File Processing fees listed.

² Per-item surcharge is in addition to the standard domestic Receipt fees listed.



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

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