

News from FedACH

VOL. 3, NO. 2, JULY 2006

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CUSTOMER IN THE SPOTLIGHT

Commerce Bank and Trust

Strengthening Its Risk Management Tools

Commerce Bank and Trust first opened in Worcester, Mass., in 1955 and has shown its commitment to serving the central Massachusetts market ever since. For this privately owned bank with \$1 billion in assets and a dozen branches, providing retail customers and small to medium-size businesses with the services they need is key. Located just steps away from its original location, Commerce Bank has not strayed from its initial goal of serving the financial needs of its business customers while providing a positive banking experience.

With an emphasis on payroll origination, Commerce Bank offers its customers a variety of ACH origination services and has established itself as the ODFI for several regional payroll companies. In fact, payroll origination accounts for approximately 95 percent of the bank's ACH origination volume, with cash concentration and dis-

bursement entries making up nearly all remaining origination volume.

Risk Management Responsibility

According to Jim Belliveau, executive vice president and chief technology officer, Commerce Bank and Trust appreciates its responsibility to provide customers with an ACH environment in which every possible measure is taken to manage and mitigate risk. With nearly 25 years of banking experience, Belliveau has seen increasing risks in the payments arena as transaction types have expanded and volume has grown. For Commerce Bank, an institution that has chosen to leverage its existing expertise by increasing payroll origination volume rather than pursuing business associated with other types of ACH transactions, mitigating and monitoring ACH risk are key concerns.

Commerce Bank and Trust's focus on risk management is evidenced through the development of several processes and procedures. Among these is the requirement that customers prefund their originations. "This is just a basic tenet of the way we do business," Belliveau said. The prefunding requirement is explained to prospective customers, and the bank monitors its corporate originators' prefunding, ensuring that they understand and comply with the policy. Another outcome of the bank's attention to risk has been the expedited availability of return item information to its customers. This product has not only helped to mitigate risk but has also served Commerce Bank well as a marketing tool. According to customers, furnishing return item information a day or two earlier than do other financial institutions has set Commerce Bank apart from its competition.

CUSTOMER IN THE SPOTLIGHT

Additionally, Commerce Bank and Trust knows its customers well. For each ACH originator, Commerce Bank knows who makes up its management team, what its growth plan is, and how the internal finances come together, right down to how the originator balances and reconciles. Prospective ACH originators must demonstrate that they know the business they are in. They must also prove to Commerce Bank that they have effective controls to reconcile and manage their funds. In summary, this ODFI is careful when accepting corporate originators. They must be well respected in their industry, understand the business they are in, and have a solid management team.

The Missing Tool

With these controls in place, one might assume that Commerce Bank and Trust had all the tools it needed. There was, however, one valuable tool missing from the toolbox. Like many banks, Commerce Bank offers its customers multiple origination channels—they can submit an ACH file to the bank or originate it via online banking—but did not have a final point at which it could set a daily limit for origination across all channels. The FedACH RiskSM Origination Monitoring Service filled this void or, as Belliveau put it, “it was the icing on the cake.”

Belliveau explained that every financial institution must understand that assessing and managing ACH risk is becoming more important, both internally and from a regulatory standpoint. Network participants will be expected to have more sophisticated monitoring in place, and they need to analyze

“The rules are in place... there is no reason that any institution should be subjected to undue risk.”

all available options for monitoring and mitigating risk. “Once participants take a look at the expectations and what they need to do, they will see that this service is an important tool for them. It’s certainly been an effective tool for us. We believe it strengthens the entire risk management program.”

Opting initially to define a limited number of originators for which ACH batches would be monitored, Commerce Bank and Trust is working toward a setup in which it defines all known originators to the risk origination monitoring service. Then, ACH batches

received from an undefined originator will be pended by the service, requiring that an authorized employee of the bank take action, either releasing or rejecting each batch. While this setup process may temporarily increase staff time spent on the risk origination monitoring service, Belliveau does not anticipate any long-term impact on staffing levels.

Industry Attention

Commerce Bank and Trust expects that its ACH processing will expand to include origination of accounts receivable entries. In addition, the bank is working with a tax collection agency on creating a new Web-enabled application that will be used to collect delinquent taxes. When asked whether he was concerned about ACH risk in light of volume growth and the expansion of transaction types, Belliveau indicated that he is satisfied with the way in which the industry is addressing ACH risk. Belliveau assured us that, “As an ODFI, we’re very careful to follow the rules, and the foundation is there for growth without necessarily increasing risk. The rules are in place, and if all participants follow the rules on the books, there is no reason that any institution should be subjected to undue risk.”

Risk Service: Here and Now

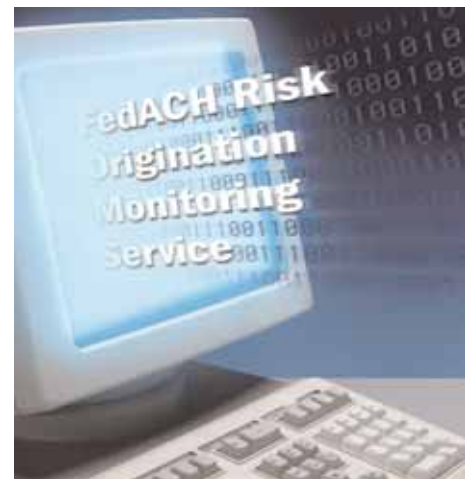
At NACHA’s Payments 2006 Conference, the Fed announced general availability of its FedACH Risk Origination Monitoring Service. The service is available to all ODFIs, and sign-up has been robust. Already, more than 50 banks have requested access to the service.

This self-service risk tool enables an ODFI to set debit and credit ACH caps across its entire organization or for specific originators. The service pends batches that exceed caps and simultaneously sends e-mails alerting the ODFI of breached caps. Pended batches are either released for processing or are

rejected by ODFI staff with authorization to access the risk service.

The service requires no additional software or hardware; it does require access to FedACH Information Services. Sign-up is an easy, two-step process: Request FedLine Web[®] role-based access via your designated EUAC and submit a completed FedACH Participation Agreement Appendix I.

To find more information about FedACH Risk Origination Monitoring Service, contact your local FedACH sales specialist or visit www.frbervices.org.





- If you missed the premiere of the FedACH Risk Origination Monitoring Service at NACHA's Payments 2006, you can visit <http://www.frbervices.org/Retail/fedachRisk.html> to learn more through a number of online resources. Choose from the online seminar *Shedding Light on ACH Risk*, a two-part video Webisode *Risk Vision 20:20*, and even take the ACH Risk Quick Quiz to begin gauging your ACH risk preparedness. If you have questions, contact your local FedACH sales specialist.

- On Sept. 15, 2006, several ACH Rules amendments become effective. (1) Dishonored return reason codes R62-R66 will be discontinued and consolidated into a single dishonored return reason code R69. A set of codes will be used within the addenda information field to specify those fields containing incorrect data. (2) Contested dishonored return reason code R74 will accommodate additional corrections that could be made by an RDFI. (3) Two new contested dishonored return reason codes, R75 – Original Return Not a Duplicate and R76 – No Errors Found, will be created. (4) Business checks ineligible for conversion to ARC and POP transactions will be defined as those either containing an auxiliary on-us field in the MICR line or those written for an amount exceeding \$25,000. A new return reason code, R39 – Improper Source Document, will be used if an ineligible item is converted. For additional information on these rules amendments, visit NACHA's site at <http://www.nacha.org>.

- **CORRECTION**—In the March issue of *News from FedACH*, the Customer Helpline on page 2 contained an error. It stated that the fee associated with using FedPhone or a paper return form in the event that FedACH Information Services was not available would be \$0.50. In fact, should FedACH Information Services be inaccessible, and a customer elects to use FedPhone or a paper return form, the associated fee would be \$0.30.

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 | Mark Taylor | 312.322.8449 |
| 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 |

UPDATE FOR FedLINE ADVANTAGE® SUBSCRIBERS

In June 2006, several enhancements were made to FedACH Services via the FedLine Advantage access solution. Subscribers are now able to download several non-payment files for the current processing day and for the previous 10 business days. These non-payment files include the Information File, the Composite Receiver File, and the Auto Advice.

The Information File, also known as "FIEF," contains the NACHA-formatted payment files for information purposes and is created once each day. The companion "FIEN" which provided notification of delivery of the Information File in the DOS-based FedLine® environment has been discontinued.

The Composite Receiver File, often referred to as the "CRF1" or "CRF2," details receivers of FedACH files and is available on a monthly schedule as either a complete list or a list of updates.

The Auto Advice, also known as "FAHA," will provide up to three settlement advices in NACHA format per processing day (i.e., one for each settlement cycle with settlement activity).

Please contact your local FedACH sales specialist if you have any questions or if you would like to sign up for these services.

WHAT'S COMING UP

JULY 2006

The Payments Institute East

July 23–27, 2006 Atlanta, GA
www.nacha.org

SEPTEMBER 2006

GACHA's Solutions 2006

September 5–7, 2006 Atlanta, GA
www.gacha.org

WesPay's Payments Symposium 2006

September 10–12, 2006 Las Vegas, NV
www.wespay.org

The Payments Authority's Concepts 2006

September 13–15, 2006 Mount Pleasant, MI
www.thepaymentsauthority.org

EastPay's Operations Technology Conference

September 24–26, 2006 Charlotte, NC
www.eastpay.org

OCTOBER 2006

UMACHA's Navigating Payments 2006

October 12–13, 2006 Brooklyn Park, MN
www.umacha.org

The AFP® Annual Conference

October 15–18, 2006 Las Vegas, NV
www.afponline.org

SWACHA's Brave New Frontiers in Electronic Payments

October 24–25, 2006 Dallas, TX
www.swacha.org

DIRECTO A MÉXICOSM FRONT AND CENTER AT CROSS-BORDER PAYMENTS CONFERENCE IN MEXICO CITY

In Mexico City, on June 4–6, 2006, the Fed co-hosted with the Instituto de los Mexicanos en el Exterior, a division of the Ministry of Foreign Affairs, and the Banco de México, "Crossing the Border: Financial Access, Remittances, and Directo a México." More than 40 representatives from U.S. financial institutions participated in this conference designed to promote account-to-account transfers as well as to provide more in-depth knowledge of the Mexican banking and payments systems.

Topics included an overview of the Mexican banking system along with descriptions of products Mexican banks offer, regulatory and legal issues in banking the Mexican community in the United States, and demonstrations of tools to enhance bank usage. One session featured presentations from U.S. financial institutions describing how they offer Directo a México and lessons they have learned along the way. The conference was a successful step in bridging together payments providers on both sides of the border.



Conference attendees from U.S. financial institutions visit a Bansefi branch in Mexico City.

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



In March 2006, NACHA – The Electronic Payments Association announced plans to organize a pilot to test online transactions in which consumers would be authenticated by their own financial institutions and initiate private, secure electronic payments via their financial institutions' online banking Web sites. In addition to organizing the pilot, NACHA will develop business cases for bank-provided online authentication and payments in the business-to-business market and for bank-provided online authentication as a standalone service.

Elliott McEntee, president and chief executive officer of NACHA, recently provided us with additional information surrounding this important pilot. Prior to joining NACHA, McEntee was an associate director at the Board of Governors of the Federal Reserve System, responsible for managing a function that oversees the nation's payments mechanism and financial services the Federal Reserve provides to banks, thrift institutions, and the U.S. government.

NACHA's Online Payments Pilot

How did NACHA's Online Payments Pilot evolve?

The NACHA Board of Directors approved the formation of the pilot in February 2006. This came after the completion of a "Proof-of-Concept" phase in which several banks, working with business and technology partners, showed that the technology works, the transaction flow is easy to understand and not cumbersome to a user, and there is a good business case.

Briefly describe the Online Payments Pilot. The pilot will test consumers' online funds transfers, bill payments, and purchases. Consumers will be authenticated by their own financial institutions and initiate private, secure electronic payments via their financial institutions' online banking Web sites.

In the pilot, a consumer chooses to complete an online transaction at a Web site using this authentication and payment method. The consumer is then redirected via a secure network to his or her financial institution's online banking Web site, where he or she logs in using the usual log-in procedure. Once securely within the financial institution's Web site, the consumer confirms the details of the transaction and authorizes payment.

Because consumers authorize payment via their own financial institutions, they do not provide their financial account information to the business or a third party; instead, it remains private between consumers and their financial institutions. Because the business does not receive and store consumers' financial account information, it does not have the responsibility of securing the information from mishandling, misuse, or theft.

What is the timeline for the pilot? We anticipate that the pilot participants will begin organizing it in August. We expect the pilot to start generating live transactions in early 2007 and to last for one year from that point.

What best distinguishes the pilot from its predecessors? This is the first time that live transactions will be completed. Previous initiatives for this payment method consisted solely of research. Market conditions have also changed. Consumers' concerns

about security and privacy are increasing, and research shows that businesses can increase sales and reduce shopping cart abandonment by offering additional payment methods.

What expectations do you have in terms of consumer and merchant response to this payment choice? We have seen tremendous interest from financial institutions, businesses, and processors. Consumer education will be an important component of both the pilot and any eventual full-scale product rollout. NACHA's consumer focus group research showed that consumers with concerns about online privacy and security were receptive to the privacy and security features and that they were able to understand the transaction flow.

Would you expect this online payment mechanism to eventually erode online credit card transaction volume? No. Research shows that consumers who use cards online will continue to do so. By enabling financial information to remain private between consumers and their financial institutions, entirely new markets of consumer transactions could be conducted online.

How can financial institutions benefit from this form of online payment? Financial institutions would take a leadership role in addressing customers' concerns about online security and privacy of account information. They would generate new interchange revenue by authenticating their customers and guaranteeing payments to businesses. Financial institutions would generate new returns on their investments in online banking platforms and their online authentication capabilities. Financial institutions would also generate new fee revenue from business customers.

Where can financial institutions find additional information? NACHA has a new Web site dedicated to the pilot at <http://www.paymentspilot.nacha.org>. There, financial institutions can find a pilot overview, product demonstrations, transaction models, technical information, research results, and recent headlines and news coverage.

FedACH SERVICES PERFORMANCE MEASURES

Year-to-Date through 1st quarter 2006

Performance Quality Measure

99.19% **Transaction files processed and available timely**

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

99.90% **ACH service availability (uptime)**

Percentage of time FedACH service was available

100.00% **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 | 1,995,690 | \$3,281,173 |
| Government Forward Value Items Originated | 270,219 | \$911,184 |
| Commercial Return Items Originated | 25,375 | \$13,781 |
| Government Return Items Originated | 2,097 | \$2,834 |
| Total Commercial and Government Non-Value Items Originated (includes NOCs, DNEs, ENRs, prenotes and zero-dollar entries) | 27,336 | N/A |
| Total Items Originated | 2,320,717 | \$4,208,972 |

2006 FedACH SERVICES FEE SCHEDULE¹

| | | |
|---|--|---------------------------|
| Origination | | |
| Items in small files (< 2,500 items) | | \$0.0030 |
| Items in large files (> 2,500 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 Risk Origination Monitoring Service | | |
| Subscription Fee | | \$20.00 /RTN /Month |
| Monitoring Fee | | \$15.00 /Criterion /Month |
| Batch Monitoring | | \$.0025 |
| FedACH International Services | | |
| Item Originated to: | Canada | \$0.0390 |
| | Mexico | \$0.67 |
| | Austria, Germany, Netherlands, Switzerland, United Kingdom | \$2.00 |
| Return Received from: | Canada | \$0.77 (surcharge) |
| | Mexico | \$0.69 (surcharge) |
| | Austria, Netherlands, Switzerland | \$5.00 (surcharge) |
| | Germany, United Kingdom | \$8.00 (surcharge) |
| | Same day Recall of Item – Canada Service | \$4.00 /\$7.00 |
| | Item Trace - Canada Service | \$3.50 /\$5.00 |
| | Item Trace - Mexico Service | \$11.50 |

¹ Refer to www.frbservices.org for additional details



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