

News from FedACH

2ND QUARTER 2008

VOL. 5, NO. 2

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FedACH SERVICES

2 Educational Opportunities



Q&A: ROSSANA SALARIS

5 STP 820 Specification

NEWS KIOSK

3

DID YOU KNOW?

3

WHAT'S COMING UP

4

CUSTOMER IN THE SPOTLIGHT

National Bank of California

Managing Third-Party Credit Risk

National Bank of California could easily rest on its laurels as it looks back on a quarter of a century of service, but for this independent community bank, the focus is on moving forward. After opening its first location in Los Angeles in October 1982, National Bank of California has expanded to include five locations serving customers in Los Angeles, Orange, and Ventura counties. With \$350 million in assets and a consistent record of earnings growth, the bank maintains its dedication to excellence in customer service as well as security and reliability. Headquartered in the Fairfax district of Los Angeles, National Bank of California attracted our attention with its controls and procedures surrounding ACH origination, particularly by third-party service providers and third party senders. With commercial ACH origination volume exceeding 10 million items in 2007

for a mix of banking customers and third-party service providers, National Bank of California has established a proven set of best practices to address ACH origination risk.

Setting Expectations High

According to Hourli Wartanian, vice president and director of electronic payments, National Bank of California maintains high expectations for its ACH staff as well as for the bank's originators and third-party service providers. Wartanian has worked in the banking arena since 1996, and she joined National Bank of California in 2006 with a background in various operations and support areas as well as in rules compliance. Now responsible for ACH rules compliance and relationship management for National Bank of California's originators and third-party service providers, Wartanian relies heavily on her

experience and her accreditation as an ACH professional (AAP). National Bank of California has found—as has the entire ACH industry—that growth in the numbers and types of transactions requires a greater emphasis on identifying and managing risk. To meet that challenge, any ACH network participant must have knowledgeable, well-trained personnel and clearly defined procedures surrounding all aspects of its ACH business. National Bank of California has addressed the first part of that equation by encouraging staff to acquire AAP certification and to take advantage of ongoing training opportunities, whether internally available or offered by NACHA or WesPay, the bank's regional payments association.

The second part of the equation—clearly defined procedures—has proven to be equally important as the first while relying heavily



CUSTOMER IN THE SPOTLIGHT

on staff expertise and knowledge. Bank management requires that established policies demonstrate a solid understanding of ACH and the credit risk associated with origination. Additionally, the bank's procedures must provide for definition of maximum risk tolerance and outline the need for underwriting and audits. Perhaps most challenging of all has been National Bank of California's commitment to ensuring that its originators and third-party service providers also adhere to stringent controls and procedures.

The Need to Accept Responsibility

While National Bank of California exercises a certain degree of oversight and control with its ACH originators, Wartanian stressed that "the bar is raised when working with our third-party service providers. We [National Bank of California] fully appreciate that we are warranting the transactions flowing into the ACH network, and we take that responsibility seriously." The bank's board of directors is fully apprised of each new third-party service provider along with its line of business, the associated risk tolerance, and its policies. National Bank of California also conducts a review of authorization methods for each originator and third-party service provider. Additionally, third-party service providers are required by National Bank of California

to fulfill extensive reporting requirements. At a minimum, they must produce reports of credit and debit exposure, unauthorized returns, and processed files. In turn, the ACH

"Know your customers.
Know their business plans.
Know what they do, how they do it, and with whom they do it. Review and monitor, then review and monitor again."

area of the bank provides its board of directors with reports of everything from origination volume by standard entry class code to origination and return dollars compared to Tier 1 capital.

Tools for Maintaining Quality

Notwithstanding its own internal controls and the standards it sets for third-party service providers, National Bank of California has determined that the FedACH Risk Origination Monitoring Service is an effective

tool when it comes to managing ACH risk. Wartanian and her staff regularly use the service to set origination caps and, ultimately, to monitor and log exceptions to those caps. Of course, there is one risk mitigation practice that rises to the top of the list when discussing ways to mitigate risk. Wartanian identified this practice as the one without which National Bank of California could not effectively manage payments risk. "Know your customers. Know their business plans. Know what they do, how they do it, and with whom they do it. Review and monitor, then review and monitor again."

When asked for a glimpse into the future for National Bank of California and its ACH business, Wartanian reminded us that much of the bank's ACH volume, whether originated through National Bank of California or via a third-party service provider, is for small businesses. She stressed the fact that the ACH network offers a solid, efficient, and valuable tool for businesses of any size. Confirming that the bank's focus is well-directed, Wartanian said, "We hope to see ACH volume grow as it has done for years, with the understanding that growth should come only from quality ACH transactions."

FedACH Services Educational Opportunities

To assist you in effectively using FedACH Services, we would like to remind each



FedACH customer of our educational materials and online learning opportunities. Whether for new ACH staff or for current staff, we hope you will find the information at FRBservices.org/eventseducation/ to be useful.

The **FedACH Services eLearning Tool** offers step-by-step instructions for navigating FedACH Services via the FedLine Web or FedLine Advantage access solutions. See exactly how to send or receive files, find information, and derive returns and NOCs. Learn about FedEDI Plus and risk management services for ODFIs and RDFIs.

The **FedACH Origination Power Kit** is designed to help you optimize your origination services by showing you ways to grow ACH volume as well as providing industry best practices and additional resources. You can also take advantage of the **Back Office Conversion Resource Center** and the **International ACH Transaction Resource Center**. (Note: March 20, 2009, is less than nine months away.)

If you have thoughts on additional educational and training materials, please contact your local FedACH sales specialist.



- In 2007, a total of \$231 million in cross-border payments flowed to Canada through the Fed's Canada Connection Service. Based on 2007 trade volumes of \$525 billion between the United States and Canada, the opportunity for growth in the number of cross-border payments is tremendous. To help our customers tap into that growth opportunity, we have recently completed market research on a state-by-state level to identify high-potential markets (i.e., target industries) for promotion of the Canada Connection Service. If you are looking for ways to increase your institution's cross-border payments volume, please contact your local FedACH sales specialist to discuss the findings of this research.

- As of mid-June, a total of 343 FedACH customers had signed up for the FedACH Risk Origination Monitoring Service. Collectively, participants in this service are monitoring more than 2,400 company IDs and 65 routing transit numbers. Visit FRBservices.org or call your local FedACH sales specialist today to find out how you can benefit from monitoring ACH origination activity at the batch level.

- Thinking of taking the AAP exam in the fall? Preparing for and taking the exam just got easier. The AAP exam will be offered electronically at more than 500 secure, computer-based testing centers nationwide starting this October. In addition, AAP candidates will have the opportunity to select a convenient test date any time in the three weeks beginning October 13 and ending October 31, 2008. There is even a practice exam in the same format as the new computer-based AAP exam. Visit www.nacha.org for more information. Remember, it's only the exam process that's getting easier—not the exam itself!

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 | 954.436.2402 |
| Boston | Jean Fisher, AAP | 617.973.3218 |
| Chicago | Mark Taylor | 312.322.8449 |
| Cleveland/St. Louis | Susan Bivens, AAP | 901.496.0626 |
| Dallas | Matt Davies, AAP | 214.922.5259 |
| Kansas City | Joni Hopkins, AAP | 620.221.2712 |
| Minneapolis | Steve Peterson | 612.204.6949 |
| 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 |

DID YOU KNOW?

New Effective Date for NACHA Rules Interpretation

The effective date of NACHA's rules interpretation on the proper use of SEC codes and the aggregation of transactions has been extended to Aug. 4, 2008. This interpretation addresses the identification of the appropriate SEC code for certain ACH transactions initiated at the point-of-sale with an access device such as a debit card as well as the practice of aggregating multiple transactions into a single ACH debit entry. The provisions of the interpretation are provided below (refer to NACHA's Web site for additional details).

- If either the POS or MTE SEC code may apply to a transaction because of the way in which it was initiated, and the WEB or PPD SEC code may apply because of the way in which the consumer originally enrolled for a product or service, the POS or MTE code, respectively, must be used.
- ACH transactions cannot be aggregated under the POS or MTE SEC codes, but they may be aggregated under the WEB or PPD codes if the transactions are accumulated in an account for more than 14 days.
- The payee of the underlying transaction being settled through the ACH Network should be identified in the Company Name field of the ACH entry.

WHAT'S COMING UP

SEPTEMBER 2008

Solutions 2008

September 3–5, 2008 Atlanta, GA
www.gacha.org

2008 Payments Symposium

September 7–9, 2008 Las Vegas, Nevada
www.wespay.org

Concepts 2008

September 17–19, 2008 Grand Rapids, MI
www.thepaymentsauthority.org

OCTOBER 2008

Navigating Payments 23rd Annual Conference

October 9–10, 2008 St. Louis Park, MN
www.umacha.org

Mid-America Payments Conference 2008

October 27–29, 2008 St. Louis, MO
www.mpx.org

Payments Summit

October 30–31, 2008 Columbus, OH
www.paymentscentral.org

FedEDI PLUS AT A GLANCE

By now, you should have heard about FedEDI Plus, but perhaps you still have a question or two about this new FedACH service. Read on to find the answers you need, and you can always call your FedACH sales specialist for additional information.

What is it? FedEDI Plus enables depository financial institutions to automatically search their FedACH transactions for financial electronic data interchange (EDI) messages. The service then translates the EDI payment and remittance information into reports that are easy to read. Your corporate customers can use these reports to match ACH payments to documentation (e.g., invoices in a B2B environment).

Why use it? FedEDI Plus can generate reports automatically on a fixed schedule, or you can request reports on an ad hoc basis. Reports are available in TXT, PDF or HTML file formats, and they can be retrieved via either an encrypted e-mail portal or FedLine. You might even find that you can reduce or eliminate backroom processing currently used for EDI reporting.

What will it cost? There are no startup fees or monthly minimum fees. Pay only for the reports you need.

- Each “scheduled report” file generated: \$0.20
- Each “on demand report” file generated: \$0.75
- Each “secure delivery” e-mail queued: \$0.20.

Where can I find more information? Visit learn.frb services.org/ to experience the service firsthand and then visit www.FRBservices.org/servicesetup/fedach/fededi.html for a complete list of steps to take to sign up for FedEDI Plus. You are just five steps away from a new and improved EDI service, so don't delay.

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

STP 820 Specification



Rossana Salaris is a senior vice president of The Clearing House Payments Company. Salaris is responsible for the Electronic Payments Network, the nation's largest private-sector ACH operator and regional ACH association, serving more than 1400 financial institutions nationwide.

Since joining The Clearing House in 1991, Salaris has led the development of strategic plans for various payments systems, training programs, marketing strategies, and direct deposit/direct payment consumer education and awareness efforts.

Salaris has served on the NACHA Board of Directors, as chairman of NACHA's Marketing Management Group, and is a spokesperson for the PayItGreen Alliance.

We talked with Salaris recently about the STP 820, a minimum remittance information standard, to find out how it can make electronic payments easier for businesses to send and receive.

In a session at Payments 2008, you referred to STP 820 as “the standard of standards.” In this context, would you define STP 820? The current standard for delivery of remittance information by large corporates is the EDI 820. We recognized that, if we wanted the industry to buy into something, we didn't need to create something brand new. Instead, we started with the existing EDI 820 specification and simply focused on data elements that are already used. After determining that EDI 820 is often tailored to suit individual companies and industries and typically provides more information than a smaller company might need, we decided to create a simplified format to serve as a “standard of standards” for a broader spectrum of businesses.

What prompted EPN to develop STP 820? We reviewed the AFP's 2001 research that identified reasons that businesses were not more actively using electronic payments. Wanting to know more about what was meant by “a lack of standards” or “a lack of integration,” we conducted our own research through surveys and focus groups of various companies. When we asked them what they needed in order to send and receive electronic payments to and from their trading partners, they told us that they didn't have the tools to initiate electronic payments with remittance information. Either their cash management package didn't have the functionality they needed to include remittance information, or their accounting package could print checks but could not generate electronic payments.

The solution seemed obvious—get the cash management packages to accommodate remittance information—but there was one problem. Different businesses and industries have different standards for remittance information. STP 820 provides just the basic 10 data elements that any company needs to post an electronic payment. This doesn't guarantee that the receiver will never have a question about a payment, but the payment can be posted to the account in a timely and accurate manner.

How does STP 820 work? STP 820 is easy to use and is designed to be user-friendly. The user does not need to know codes or formatting. STP 820 is

straightforward and not at all technical on the front end. The user is prompted to enter any of the 10 data fields (e.g., name, account number, invoice number) and doesn't have to worry about formatting the field. On the receiver's side of the transaction, STP 820 can eliminate a lot of the manual work previously required for posting of entries because the remittance information is electronically transmitted rather than sent separately or, in some cases, not at all. STP 820 is not intended to replace EDI but can be used to complement it. Those who have invested resources in customized EDI packages can continue to use EDI, but there may be trading partners who are not equipped to accept EDI, and STP 820 fills that gap.

Are there barriers to widespread adoption of STP 820? Adoption will take time, primarily because software providers are at various stages of building STP 820 into their packages. Additional time will be needed to test the software and roll it out to customers. Once customers have access to STP 820, education becomes critical to businesses needing to build a business case for electronic payments. For example, businesses are expert on the topic of check float, and they have expressed concerns about losing that float if they move to electronic payments. We must explain that, as the originator, a business retains control of the payment and determines the time at which it sends payment to its trading partners. The receiver, on the other hand, can anticipate payment on the date established, with confidence that the funds are good. The end result for both parties to the transaction is better cash management. Financial institutions have an opportunity to educate their corporate customers on how electronic payments can improve their cash management efforts, particularly when those payments are accompanied by remittance information.

How would adoption of STP 820 increase the volume of electronic B2B payments? Adoption of STP 820 will create more opportunities for businesses to make electronic payments, naturally leading to growth in the ACH network. The consistent

continued on page 6

continued from page 5

message from corporates is “we know electronic payments are inevitable, and we will not be using checks forever.” Businesses are looking for the best solution when making payments to their trading partners, and the answer is to give them the tools they need in order to choose electronic payments.

What benefits might a company of any size expect to realize as a result of adopting STP 820? STP 820 was designed to benefit businesses of any size. Although large corporates may have invested significant resources in EDI, they do business with midsize and small businesses that may not have EDI capability. As a result, the large business may receive electronic payments, but the accompanying invoices and remittance information are transmitted via facsimile or e-mail. Small businesses have also expressed interest in moving toward electronic payments in order to gain efficiencies. They have consistently told us, “make electronic payments as easy as writing a check.” After all, if electronic payments are more efficient and more affordable, they should also be easier.

In any size business, the inability to transmit remittance information along with the electronic payment leads to manual reconciliation of payments. STP 820 will allow staff to spend time on more productive efforts, as the manual reconciliation would be limited to exceptions rather than every incoming payment.

What is the outlook for adoption of STP 820? In the last year and a half, we have seen that financial institutions and businesses are “getting it.” Payments tools that use STP 820 provide a way to help them make electronic payments with their trading partners. It is important to realize that STP 820 is not a solution only for EPN customers; it is not an EPN standard. Instead, STP 820 is an ANSI X12 standard designed to meet an industry need by making it easier for any corporate customer of any financial institution to initiate electronic payments with remittance information. We have seen growth in adoption of STP 820, and increasing numbers of software packages now include STP 820. It may not represent “corporate payments nirvana,” and it may not be the standard in 50 years, but it can help move the industry forward in terms of electronic payments between businesses of all sizes.

2008 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 |
| Web-derived Returns / NOCs | \$3.00 |
| FedPhone-derived Returns / NOCs | \$2.00 |
| Facsimile Exception Returns/NOCs | \$15.00 |
| Information Extract File Subscription | \$20.00 / RTN / Month |
| Account Servicing | \$25.00 / RTN / Month |
| FedACH Settlement | \$20.00 / RTN / Month |

FedACH Risk Origination Monitoring Service

| | |
|---|----------------|
| Monitoring Criteria (per set of criteria) | |
| For sets 2-20 | \$8.00 / Month |
| For sets 21-150 | \$4.00 / Month |
| For sets 151 and above | \$1.00 / Month |
| Batch Monitoring | \$0.0025 |

FedEDI Plus

| | |
|----------------------------|---------------|
| Scheduled Report Generated | \$0.20/report |
| On Demand Report Generated | \$0.75/report |
| Secure Delivery (e-mail) | \$0.20/e-mail |

FedACH International Services

| | | |
|-----------------------|--|--------------------|
| Item Originated to: | Canada | \$0.0390 |
| | Mexico | \$0.67 |
| | Austria, Germany, Switzerland, United Kingdom | \$2.00 |
| Return Received from: | Canada | \$0.77 (surcharge) |
| | Mexico | \$0.69 (surcharge) |
| | Austria, 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.frbsservices.org for additional details



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

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