Accounting for ACH losses: What are the right numbers to crunch?

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From talking with a number of industry players, it has become increasingly clear that there is both a healthy desire for ACH origination loss data to help understand risks and also business practices that limit the extent to which data to benchmark ACH losses are available in the first place. The challenge is to reconcile these two conflicting objectives.

Many banks today treat ACH origination as credit underwriting, particularly for business customers. Given this, one way banks may account for losses as a result of ACH origination is as credit losses against loan loss reserves or other similar accounts. This method is entirely appropriate as a risk management practice given the potential for losses the ACH originating bank may incur as a result of unauthorized debit items that are returned by the receiver through its bank. The originating bank, having already credited its customer’s account, may find itself unable to collect the returned item and thus may incur a loss.

NACHA does publish aggregate trend data on what is probably the best metric it has available — unauthorized returns as a percentage of all ACH debits in the network. While this is a good starting point, it is not a fully accurate picture of the actual losses banks may incur as a result of ACH origination (whether for debits or credits). While the trend of unauthorized debit returns is instructive, it does not explain the dollar losses to banks.

Further, while it is likely that most banks track or have the ability to track their losses from ACH origination, there is no standard regulatory or other financial reporting for banks to report ACH loss information. Such losses may be attributable to fraud or not, but the extent of these losses in terms of aggregate dollars and velocity is likely to be a more robust data point for analysis of ACH fraud and ACH origination risks than the data available today. Improved data on banks’ ACH loss experience would go a long way to explain the true extent of ACH origination risk within the network overall and may promote banks’ ability to benchmark their own losses in an effective way.
It also would enable both the network and individual banks to better tailor their risk management efforts. Most importantly, having more data could help dispel any mistaken assumptions about how much financial loss banks are experiencing from operational and fraud risks in ACH origination activities.

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