

How to Use This Manual

The expanded use of the automated clearing house (ACH) network has prompted many financial institutions to have an increased focus on ACH risk management. Volume growth, dollar growth, third-party sender relationships, and the increased use of higher risk ACH transactions make it imperative for financial institutions to have well developed and well documented policies and procedures in place to help control risk and ensure compliance with the ACH Rules and regulations governing ACH transactions.

Although there is risk associated with processing all types of payments, this manual concentrates on managing risk associated with the processing of ACH transactions. A financial institution can use the manual to identify and control risk when:

- Receiving ACH transactions
- Originating ACH transactions
- Using the services of a third-party service provider
- Originating ACH transactions for a third-party sender

The following are just a few of the many reasons why an institution would want to have an established ACH risk management program:

- There are transactions that may be processed through the ACH network that have higher levels of risk associated with them. Due to the anonymity of the consumer when authorizing ACH debit transactions over the Internet or by telephone, the originator is more vulnerable to fraud if sufficient risk management controls are not in place.
- Certain electronic check conversion transactions do not require written authorization. If the originator does not provide the required notice to the check writer, the originating depository financial institution (ODFI) is at risk for noncompliance with the ACH Rules and with federal Regulation E.

- The financial institution that has a relationship with a third-party service provider or a third-party sender assumes additional risk for potential noncompliance with rules and regulations by the third party.

A financial institution can institute a risk management program, or enhance its existing risk management controls, by applying the risk management recommendations and suggestions in the manual, and by customizing the sample documents contained throughout the manual.

A financial institution that does not have adequate ACH risk management controls in place can leave itself open to:

- Operating errors that result in potential rules violations
- Fraudulent file or transaction possibilities
- Venturing into new areas of ACH processing without proper risk evaluation
- Harming the financial institution's reputation
- Originating ACH transactions that exceed the financial institution's legal lending limit

The speed at which the ACH payments environment is evolving places demands on financial institutions to keep pace with ever-changing risk management requirements. Updated periodically, this manual is an excellent reference tool for financial institution personnel, regulators, examiners, and auditors.

ORGANIZATION OF THE MANUAL

Getting Started

Chapter 1: ACH Business Summary

Just as with any other business venture, participation in the ACH network should be entered into with the full understanding of how ACH fits into the strategic plan of the financial institution, and only after the associated risks have been fully explored. This chapter provides guidance for developing a written statement that describes why the financial institution is in the ACH business.

Risk Management

Chapter 2: Risk Management for the Receiving Financial Institution

Potential risk to the receiving depository financial institution (RDFI) comes primarily through noncompliance with the ACH Rules and regulations that govern the handling of ACH transactions. This chapter explores not only how the RDFI can control this risk by establishing and adhering to operational policies and procedures, but what other risk controls can be put in place to address the general risks inherent to the processing of received ACH transactions.

Chapter 3: Risk Management for the Originating Financial Institution

The risk associated with originating ACH transactions is greater than the risk associated with receiving ACH transactions. This chapter explores risk and risk management as it relates to (1) the ODFI's relationship with the originator, (2) the ODFI's compliance with the ACH Rules, and (3) general processing of originated ACH transactions.

Chapter 3A: Fraud Risk

Fraud risk can be introduced into the automated clearing house (ACH) network through the origination of purposely erroneous transactions. Fraud can also occur when changes are made to valid originated or received transactions or when data that control the routing or settlement of valid ACH transactions are purposely corrupted. Especially during tough economic times, financial institutions can expect an increase in attempted fraud, and need to have controls in place to minimize fraud risk.

Chapter 4: Third-Party Service Provider Relationship Risk Management

A financial institution may choose to outsource some or all of its ACH processing to a third-party service provider. Using the services of a third-party service provider for processing ACH transactions means added risk to the financial institution. The RDFI or ODFI using the services of a third-party service provider can manage the relationship risk by applying the risk management controls outlined in this chapter.

Chapter 5: Third-Party Sender Relationship Risk Management

A third-party service provider is considered to be a third-party sender when the third-party service provider has a processing agreement with a financial institution in which the financial institution agrees to act as the ODFI for the third-party sender. A relationship between an ODFI and a third-party sender adds a high level of risk to the origination process. This chapter highlights the risk management controls the ODFI should have in place before originating ACH transactions for a third-party sender.

Risk-Based Audit

Chapter 6: What Every ACH Auditor Should Know

The person conducting an ACH audit should have a good understanding of the ACH network, the ACH Rules and regulations that govern ACH transactions, and what policies and procedures a financial institution should have in place to address the risk associated with ACH processing. This chapter provides an overview of the ACH network and rules, and includes a checklist that can be used to prepare for conducting a risk-based ACH audit.

Chapter 7: Risk Based ACH Audit

Financial institutions should anticipate that regulators and examiners will increasingly be asking to review the financial institution's annual ACH audit, as well the audits of the third-party service providers and third-party senders with which the financial institution has a relationship, and will be expecting to see risk-based audits. This chapter details how to conduct a comprehensive risk-based audit and includes sample worksheets and audit reports.

Regulation Risk Management

Chapter 8: Rules and Regulations that Affect ACH Risk Management

The ACH Rules govern the way in which ACH transactions must be processed by receiving and originating depository institutions. There are also regulations that cover how financial institutions

must handle certain banking transactions, and certain ACH transactions fall under these regulations. This chapter looks at risk management from the regulation perspective.

Rules Enforcement

Chapter 9: Managing Risk Through Rules Enforcement

Financial institutions can help manage risk in the ACH network by enforcing compliance with the ACH Rules through the reporting of possible rules violations. A financial institution should not consider any possible rules violation insignificant. Possible rules violations that can be reported may be either: (1) a direct violation of an ACH Rule, or (2) a breach of warranty identified under the rules. Chapter 9 describes violation classifications and fines.

Appendixes

The appendixes provide pertinent resource information to assist financial institutions with managing the risk related to receiving and originating ACH transactions.

Appendix A: Glossary of Terms

Appendix B: Regional Payments Association Contact Information

Appendix C: ACH Operator Contact Information

Appendix D: Federal Reserve Bank Operating Circular 4

Appendix E: Risk Management Guidance

Appendix F: 2006 Electronic Payments Network: Rules of Membership and Operating Rules

Appendix G: Resources