

Same-Day ACH

An Opportunity for Leadership

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ABOUT ICBA

The Independent Community Bankers of America®, the nation's voice for more than 7,000 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services. For more information, visit www.icba.org.

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Same-Day ACH: An Opportunity for Leadership

In August 2012, NACHA's membership did not approve the Expedited Processing and Settlement Rule that would have supported the same-day settlement of Automated Clearing House (ACH) transactions as a ubiquitous capability of the ACH network. This rule would have added additional file pickup times to provide for same-day, instead of next-day, ACH settlement.

A majority of NACHA's voting member financial institutions and regional payments associations voted in favor of the rule, but the rule did not receive the required number of supermajority votes in order to be approved. While the ACH network has proven to be a safe and reliable payment system for almost 40 years, ICBA contends that adding same-day capabilities is crucial to ensuring that the ACH network remains a viable, relevant and efficient network for all financial institutions and their customers. ICBA strongly believes that an accelerated transition to same-day ACH is vital to all ACH participants—financial institutions, consumers and businesses with or without a NACHA rule change.

ICBA strongly supports same-day ACH and encourages community banks and their correspondent banks and processing providers to take action. Specifically, ICBA recommends community banks:

- **Adopt same-day ACH services;**
- **Encourage correspondent banks and processing providers to adopt and support same-day ACH services;**
- **Collaborate to identify specific uses and geographies for collective participation among banks where same-day ACH provides value; and**
- **Encourage regional payments associations to aggressively advocate for same-day ACH.**

Same-day ACH levels the playing field between community banks and larger competitors.

ACH is an efficient and scalable service that all banks, regardless of size, can participate in. A modernized, efficient ACH that remains competitive with other payments network settlement options (such as the check imaging network, which in many cases clears faster than ACH transactions) will yield long-term benefits for community banks.

Same-day ACH allows community banks to stay competitive with large banks and non-bank payments providers, many of which can already offer same-day payments via on-us

transactions, direct exchanges, proprietary exchanges (“on-we”) among limited-participation groups, and book entry transfers within proprietary or closed systems.

Finally, same-day ACH capability is important in helping financial institutions stay at the center of serving their customers’ payments needs, particularly as they compete with non-bank providers. A transition to same-day ACH allows for same-day settlement and returns, while maintaining the ubiquity that the ACH network already offers.

Customers expect emerging payments, such as mobile and person-to-person (P2P) payments to be faster.

As the market for mobile payments unfolds, providers and networks are jostling for a favored position, providing a strategic impetus for the ACH network—of potentially the greatest benefit to the broadest set of financial institutions—to become more actively engaged. For these transactions, customers expect, at a minimum, a faster settlement than traditional methods, such as paper checks.

Currently, consumer payments can be delivered and settled via the ACH network as soon as the next banking day, but more commonly it takes three or more banking days to post due to conventional processing arrangements. Typically, when a community bank or a credit union allows a consumer to initiate a payment to another consumer via its website or mobile banking application, the customer is “handed off” to a service provider’s web platform to complete the payment. The service provider, using a “split-payment” model, originates an Internet-initiated debit to the customer’s checking account to collect the funds; and, after waiting two banking days for the return timeframe to pass, the service provider originates an ACH credit to the recipient. Depending on the timing of each step, same-day ACH capability could shorten this overall timeframe by several days without increasing the risk of insufficient funds. Additionally, under a same-day ACH environment, notification of any returned funding debit could occur as early as the day the funding debit is originated.

Same-day ACH could also enable financial institutions’ online bill payment products to offer premium, expedited bill payment options to customers with payments initiated in time to clear and settle the same day. Another prominent benefit flows to financial institutions that issue credit cards. The Credit CARD Act of 2009 mandates that payments to credit card accounts received by 5 p.m. local time on the due date are considered to be paid on time even if the payment is not settled until the following banking day. Using same-day ACH would reduce issuers’ credit risk for the time period after they have credited cardholders’ accounts but do not yet have receipt of the funds.

Emerging payments such as mobile and P2P might also benefit from a real-time notification or messaging about the underlying same-day ACH credit payment. In the current market, real-time typically implies instant authorization for funds and includes a memo posting of the transaction. This enables the recipient to have real-time or near-real-time access to funds regardless of when settlement occurred. Even with a real-time message, a same-day settlement of the underlying ACH credit would reduce the settlement risk to the receiving bank.

Migration to same-day ACH benefits banks that originate corporate payments.

Many billing companies use ACH debits extensively to collect bill payments from their consumer customers. The availability of a widespread same-day ACH capability could be of great value to such originators in order to collect payments faster. For example, a biller that receives a large number of check payments at a lockbox location during the morning would be able to collect those payments using a same-day capability by converting to ACH using Accounts Receivable Entries (ARC). Similarly, a biller whose customers use its website to authorize payments (i.e., the biller direct model) could use a same-day ACH entry to collect those payments faster.

In addition to collecting payments faster, a biller would be able to learn about returns more quickly. Currently, an ACH debit originated on a Monday settles on Tuesday and the return deadline is Thursday morning. But if the originator meets the same-day ACH deadline, the debit originated on Monday would settle on Monday at 5 p.m., pushing up the return deadline to Wednesday morning—a full day sooner, reducing originator risk.

Many community banks are also billers for their own portfolios of card balances, mortgages and other loans. As billers themselves, these banks would benefit from being able to collect payments faster, particularly for card issuers that are required to provide credit for payment on an account on a same-day basis.

Adoption of same-day ACH allows prompt, efficient delivery of payroll.

Same-day ACH can provide a premium capability for processing certain payroll payments. A company with a large number or percentage of hourly/temporary workers, for example, is not able to properly process its Friday payroll for its paid workers because the pay period is not completed prior to ACH file submission deadlines. By using same-day ACH, however, the company is able submit total hours worked through Thursday and still submit payroll and ACH

files on Friday morning in time for a Friday payday. Additionally, payroll processors can reduce credit risk by using same-day ACH debits to fund payrolls from their client companies.

The availability of same-day ACH also enables employers to meet their payday obligations in the case of a payroll-related emergency or missed file submission deadlines without incurring extra work for the employer, its bank and the receiving bank. Additionally, same-day ACH provides employers with the ability to pay terminated employees on the day of termination, a requirement in many jurisdictions. Lastly, payroll errors can be remedied more quickly using same-day ACH. A “Payroll Performance Study” in 2009 from the American Payroll Association reported a payroll error rate of 2 percent.¹

Same-day ACH yields benefits to receiving banks and their customers.

Same-day ACH has significant benefits for receiving banks.

- Earlier receipt of some ACH credits results in the faster flow of funds. Since smaller financial institutions are predominantly net credit ACH receivers they may receive relatively more same-day credits.
- An increase in the use of direct deposit for payroll would replace many paychecks that are deposited in branches and eliminate the high-processing costs of these transactions.
- In the case of FedACHSameDay, same-day ACH service provides a late afternoon window for expediting eligible same-day returns.
- Expedited processing of debit returns results in earlier re-crediting for the receiving bank.
- Counter-party settlement risk on received ACH credit transactions is reduced;
- Banks have more processing windows available in the event of missed file deadlines or system outages and same-day ACH also enables faster recovery in these contingencies.

In addition to these specific benefits, same-day ACH may make it more attractive for retail banks to become originating banks for consumer payments initiated via online and mobile banking platforms such as bill payments and P2P payments described above.

¹ <http://www.americanpayroll.org/payrollmetrics/study-results/>

Same-day ACH reduces settlement risk for all banks.

Same-day ACH offers the opportunity to reduce overall settlement risk, including counterparty risk, to all network participants.

- *Counterparty and settlement risk* - Accelerating some ACH entries from next-day to same-day settlement reduces the duration of exposure to counterparties, thereby reducing systemic and liquidity risks proportionately. For example, a bank that receives a same-day ACH credit will know before the close of business that the transaction has settled, and that it does not face the risk of an overnight default of the originating bank.

Same-day ACH entries that use the existing multilateral net settlement feature of the ACH network would have lower counterparty exposure to participants than with bilateral arrangements that settle through correspondent accounts and are remitted via wire transfer.

- *Transaction risk* – The acceleration of returns further reduces credit exposure for originating banks and their customers through shorter duration of debits outstanding. By collecting debits faster, the Originating Depository Financial Institution's (ODFI) exposure through a line of credit to an originator such as a biller is reduced. The ODFI could increase the amount of ACH activity it permits for such an originator without increasing its overall exposure. For the receiving bank, the acceleration of debit returns results in faster re-crediting of its position.
- *Contingency planning* – In today's processing environment, parties do not have an alternative to submitting files under the next processing window with its associated settlement time. In a same-day ACH environment, the next available window and its associated settlement times is always sooner than what exists today; therefore recovery would be faster in the case of a missed deadline or emergency.

The immediate and long-term benefits of same-day ACH are worth the associated costs.

Receiving financial institutions should compare the cost of same-day participation against the benefits derived from receiving same-day payments. Among the benefits:

- Same-day ACH participation reduces deposit balances overnight in proportion to the same-day ACH debit dollar volume moved from next-day to same-day settlement.
- Receivers of same-day transactions using the Federal Reserve service incur no operator-imposed transaction fees.
- Interest expense on receiver accounts in proportion to the aggregate same-day dollar volume is reduced for receiving banks.

Even with these benefits and the ability to remain competitive in a marketplace that increasingly expects faster payments receiving banks should be mindful of several operational and cost considerations:

- Same-day ACH requires more frequent receiving bank file pick-ups from the Federal Reserve which could extend staff hours to accommodate the late afternoon processing window (particularly if the receiving bank wants to process returns on the same day).
- The management of late-day debits and the impact on correspondent balances must be addressed. The FedACH Risk Receiving Depository Financial Institution (RDFI) Alert Service which monitors the receiving bank's incoming FedACH files is a possible solution.
- As expressed by the Association of Financial Professionals and others, corporate receivers have similar concerns with unexpected late-day debits to their account. This issue can be addressed by offering controlled disbursement account services similar to those offered for checks.
- ACH processing system upgrades may be necessary.

Adopting and advocating for same-day ACH makes a positive statement in the future of payments.

Technological innovation has raised customer expectations regarding faster payments. If lower-cost enhancements like same-day ACH can be supported with changes like rules modifications and selected advances in technology, banks should consider proactively supporting such an evolution.