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AN OVERVIEW OF ACH

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Automated Clearing House

Automated Clearing House (ACH) is an electronic network for financial transactions in the United States. The ACH network processes large volumes of credit and debit transactions in batches, transferring funds between the bank accounts of consumers, businesses and government agencies. In 2012, the number of ACH payments exceeded 21 billion, an increase of more than 4 percent over the year prior.

ACH credit transfers include direct deposit payroll and vendor payments. ACH direct debit transfers include consumer payments on insurance premiums, mortgage loans, and other kinds of bills. Both the government and the commercial sectors use ACH payments.

Rules and regulations that govern the ACH network are established by NACHA (formerly the National Automated Clearing House Association) and the Federal Reserve. Credit card payments are handled by separate networks (Visa, MasterCard, American Express, Discover).

The Role of NACHA

NACHA manages the development, administration, and governance of the ACH Network, the backbone for the electronic movement of money and data in the United States and is funded by the financial institutions it governs. The ACH Network serves as a network for direct consumer, business, and government payments, and annually facilitates billions of payments such as Direct Deposit and Direct Payment. Utilized by all types of financial institutions, the ACH Network is governed by the NACHA Operating Rules, a set of rules that guide risk management and create certainty for all participants.

Who Uses ACH

ACH is used by the private sector, companies, and even institutions like The Federal Reserve to quickly and safely transfer monies. There are literally trillions of dollars in financial transactions completed annually using the Automated Clearing House. Federal Reserve banks conduct the majority of ACH transactions, approximately 60 percent, across the country. If there is an exchange of funds that does not include a paper check or other tangible form of payment, ACH



is most likely the process being used. Two common ACH examples include the direct deposit of paychecks or tax returns.

How ACH Works

The ACH process works like this: a person or company first authorizes a transaction (a purchase at a store, for example) to occur. The Originator (a merchant, for example) then collects certain information, such as check account and routing numbers. This information is then forwarded to an Originating Depository Financial Institution (ODFI) or Third-Party Service Provider, where the data gets deposited into the ACH network. An ACH operator then distributes that information via electronic ACH files to the appropriate Receiving Depository Financial Institution (RDFI); which is usually the bank of the person or company that initiated the transaction (a.k.a. the check writer). The RDFI then processes the transaction, and updates the account information.

Third-Party Service Provider

A Third-Party Service Provider is an entity other than the Originator, ODFI, or RDFI that performs any functions on behalf of the Originator, ODFI, or RDFI with respect to the processing of ACH entries. Profituity is considered a Third-Party Service Provider. Profituity performs ACH processing by creating ACH files on behalf of our Originators (merchants). We have established relationships with ODFIs who then process the files we send to them on behalf of our Originators.

Various Types of ACH Transactions

NACHA requires that when a transaction is submitted to the Federal Reserve for processing that the transaction must include something called a Standard Entry Class (SEC) Code to communicate exactly how the customer gave you authorization to debit/credit their bank account. SEC Codes are three-character codes assigned to transactions that identify the type of transaction when submitted through the Automated Clearing House. Below is a list of the most common SEC Codes and their intended use:



- ARC - Accounts receivable conversion. A single entry debit initiated by an Originator (merchant) to the account of a Receiver (check writer) based on an eligible source document (check) provided to the Originator by the Receiver: (1) via the U.S. mail or delivery service (2) at a dropbox location, (3) in person for payment of a bill at a manned location.
- BOC – Back Office Conversion. Enables Originators (merchants) to convert, during back office processing, eligible source documents (checks) presented by the Receiver (check writer) for payments made at either the point of purchase or a manned bill payment location. BOC entries are single entry debits.
- CCD – Corporate Credit or Debit. Credit or Debit entries used to facilitate business-to-business ACH payments.
- PPD – Prearranged Payment and Deposit Entry. A credit (direct deposit) or debit (direct payment) entry originated by an organization to a consumer’s account, based on standing or single-entry authorization from that consumer. PPD entries can be used for both recurring and non-recurring (single-entry) payments.
- POP – Point of Purchase. A single-entry ACH debit originated based on an eligible source document (check) provided to an Originator (merchant) by a Receiver (check writer) at the point-of-purchase.
- RCK – Re-Presented Check Entry. Single-entry debits initiated by Originators to re-present paper checks electronically after the paper checks have been returned for insufficient or uncollected funds.
- TEL – Telephone Initiated Entries. A consumer debit transaction in which the Originator (merchant) obtains the Receiver’s (check writer) authorization for the debit entry orally via the telephone.
- WEB – Internet-Initiated/Mobile Entries. Used for the origination of a debit entry (either single or recurring) to a consumer’s account based on an authorization from the Receiver (check writer) to the Originator (merchant) via the Internet or a Wireless Network.



Consumer and Non-consumer Checks

Consumer checks, or personal checks, are eligible to be sent through the ACH Network whereas non-consumer checks are not eligible. Examples of non-consumer checks include:

- Business checks
- Money market checks
- Money orders
- WIC checks

Check 21

Check 21 is a federal law that is designed to enable banks to process more checks electronically. Instead of physically moving paper checks from one bank to another, banks can capture a picture of the front and back of the check along with the associated payment information and transmit this information electronically. If a receiving bank or its customer requires a paper check, the bank can use the electronic picture and payment information to create a paper "substitute check."

A substitute check is a check made from an electronic image of the original check. The paper check is scanned and then a digital image is produced. With Check 21, the substitute check, or an electronic image of the original paper check, replaces the original physical check. The substitute check is the legal equivalent of the original check and includes all the information contained on the original check.

Drafts

A draft (also known as bank draft, demand draft, or check draft) is a legal copy of a check writer's check, created typically by a merchant (or processor) and is authorized by the account holder (check writer). The check that is created has the check writer's account information on it and requires no signature.



The authorization for the paper draft can come from a variety of sources, such as telephone or web. Once the authorization has been obtained, then the actual draft is the physical item that is printed. Drafts are treated like physical checks and are not sent through the Automated Clearing House.

The main difference between a Check 21 and a draft is that a Check 21 is a representation of an original check and is sent with the check image. A draft on the other hand has no image. Both are paper items and are processed the same way. Neither is sent through the ACH network.

What is Remote Deposit?

Remote deposit refers to the ability to deposit a check into a bank account from a remote location, such as an office or home, without having to physically deliver the check to the bank. This is typically accomplished by scanning a digital image of a check into a computer, and then transmitting that image to the bank. This service is typically used by businesses, though a remote deposit application for consumers has been developed.

What is Verification?

A verification service provides businesses or individuals with either the ability to confirm the validity of the actual check or draft being presented, or the ability to review the history of the account holder, or both.

Some verification services will use a Negative Database. A Negative Database contains a comprehensive list of people who either wrote a bad check at a retail location or made a payment that was returned.

Other verification services use a bank account validation network that can poll the results of the actual bank account to get the current status from the bank. These systems provide a result that is based on the bank account's actual status provided by the bank as of that business banking day. It will tell you if there is an open active account at that bank and if the check is likely to clear. Status messages such as closed account, NSF, stop payment or invalid account can help determine if a check or ACH transaction will be good. The results are based on account validity,



so there is no way to know if the check will actually clear when it is presented, or if the exact dollar amount is going to be available.

What is Check Guarantee?

Verification services are often times bundled with check guarantee services, but they are two separate and distinctly different services. A check guarantee service will guarantee the payment of a check (usually up to a specified amount) provided that the merchant accepting the check follow a prescribed set of procedures.

These procedures typically require that the check be pre-approved (through their verification service) and that the merchant obtain additional information from the check writer (such as a driver's license, social security number, and home and work phone numbers). It is important to note that even if a check gets approved, it does not mean that it will clear. If the check does not clear, then the check guarantee company will still pay the face value (or up to a specified amount) of the check as long as the merchant followed their procedure.

What is Representment?

Representment is the process of attempting to collect on a payment returned as NSF (non-sufficient funds). If it was a consumer check, the representment would typically be in an electronic format submitted through the ACH network, which is electronic check recovery. However it is not a requirement that a consumer check to be represented in this way. A returned consumer check may also be represented as a Check 21 or a draft.

If it was a non-consumer check, the representment must be in the form of a Check 21 or draft.

Non-consumer checks are not eligible to be processed through the Automated Clearing House. Eligible returned payments, those returned as insufficient or uncollected funds, may be represented through the ACH network up to two additional times.



Representment may be performed on checks converted to electronic transactions (such as ARC, BOC, and POP), or other electronic debits (such as PPD, TEL and WEB). These checks are identified with the original SEC code that was used at the time of the origination.

The process may also be performed on paper checks that were not electronically converted and instead were deposited at the bank. These checks are identified with an SEC code of RCK when they are re-presented through the ACH network.

What is a Return Check Collection Fee?

A return check collection fee may be charged to a check writer when a check or ACH transaction is dishonored and returned unpaid. Checks or ACH payments can be returned for a number of reasons (Stop Payment, Account Closed, etc.), but the majority is returned because of insufficient funds. This fee is separate from any fees the check writer may have incurred by their bank (such as Overdraft fees). The fee amount that can be charged is regulated by the state in which the merchant is located and can be charged by the merchant or their third party-party service provider.

Returned check collection fees may be electronically debited against the check writer's account if proper authorization is in place. These fees may also be presented in the form of drafts. Return check fees are not initiated against the check writer's account unless the original item is eligible for representment.

Secondary Collections

Secondary collection is traditional collections performed by a payment collection agency. Checks or ACH payments that are ineligible for representment, or that have exhausted the available electronic attempts, may be forwarded on to secondary collections. Secondary collection methods typically involve communication by phone and/or letter in an effort to recover the original value of the payment plus additional punitive fees.



Glossary

ACH: Automated Clearing House. Automated Clearing House is a payment network for inter-bank clearing and settlement. The ACH system is governed by the National Automated Clearing House Association (NACHA).

ARC (Accounts Receivable Lockbox): Electronic entries created from consumer or small sized business checks received through the mail or at an unattended drop box and converted to an electronic transaction. Requires notice to consumer that item will be converted. Notice can be printed on invoices, catalogues, etc.

Authorization: Consent by consumer or business for the origination of a particular transaction.

BOC (Back office Conversion): Electronic entries created from consumer or small sized business checks received at the point of purchase and converted later, in the back office. Requires notice to the consumer at the point-of-sale that the item will be converted.

CCD (Cash Concentration or Disbursement): One-time or recurring debit/credit to a corporate account. Requires signed authorization.

Check 21: Items that are usually processed as Image Replacement Documents (IRD's). These are items that would normally be deposited as checks, but are not eligible to be processed through the ACH. Examples of these items are business checks, money market checks, paper drafts not having a signature, money orders, etc.

Hold Time: The amount of time a debit or credit is held before funds are released.

Image Replacement Document (or IRD): See Check 21

Paper Draft (DFT): Non-ACH paper document printed at Check Assist's bank and deposited manually. Primarily used for the collection of state authorized fees when merchant does not



have written authorization from consumer to electronically debit his/her account. Requires notice at the point of sale.

POP (Point-of-Purchase): Electronic check entries created using a consumer or small sized business check that is scanned at the point of purchase and converted to an electronic transaction. Requires a signed authorization by the consumer.

PPD (Predetermined Payment & Deposit): One-time or recurring debit/credit to a consumer account. Requires signed authorization.

RCK (Re-presented Check): Electronic re-presentation of checks that have been returned NSF or Uncollected funds. A check may be presented up to 3 times total; 2 times as a paper item and 1 time electronically (RCK) or 1 time as a paper item and 2 times electronically (RCK).

TEL (Telephone Initiated): Single entry electronic payments or deposits to a consumer account initiated by the consumer via telephone. Requires record of call or written confirmation.

Transaction: Debits, credits, paper drafts, Check 21

WEB (WEB Initiated): Single entry electronic payment initiated via website.

