

ACH "Debit Block/Filter" Overview

The Automated Clearing House (ACH) Network is a system used by financial institutions to process millions of payments each day. The system utilizes a network of ACH associations, of which most major banks are members. The transactions take place in a batch mode, by financial institutions transmitting payment instructions through the system of clearinghouses. In 1999, over 6.2 billion ACH payments were made in the US, reflecting a 16.9% annual increase in volume. As the pace of electronic commerce quickens, and with the price advantages of ACH payments versus other payment mechanisms such as checks and wire transfers, the volume of ACH transactions will continue to increase.

The most common form of ACH transactions for consumers is the ACH credit, which is the transaction type used for direct deposit of payroll. In that transaction, the employer is the Initiator of an ACH credit (the Payor) and the employee is the Receiver (the Payee) of that ACH credit. ACH debits are becoming more prevalent for consumers, with the first adopters being health clubs who debit their members' bank accounts for club dues. In that transaction, the health club is the Initiator (the Payee) of the ACH debit, and the member being debited is the Receiver (the Payor). Because of the risks associated with ACH debits posting to University accounts without our authorization, the Office of the Treasurer has prepared this document to highlight the risks and safeguards available.

While the University currently protects itself against check fraud utilizing controls such as check stock security features and Positive Pay, we currently do not have in place any controls that would prevent fraud perpetrated using the ACH system. If an unauthorized debit were to occur in the current environment, it would only be recognized after-the-fact, through active account monitoring or during bank account reconciliation. There are bank services available, however, that can actually help to prevent unauthorized debits from posting to our accounts. Generically, these are known as Debit Blocks.

Why Are Debit Blocks Needed?

The ACH System is governed by rules, policies and procedures written by The National Automated Clearing House Association (NACHA). Under current NACHA Rules, the Originator of an ACH debit (the payee) must have proper authorization from the Receiver of the ACH debit (the payor) before such a transaction can be initiated. This requirement, however, is only legal, and it does not prevent someone from initiating an ACH debit without proper authorization. Without a debit block in place, any ACH will post to an account, regardless of whether it is properly authorized.

"Unauthorized" debits can be returned; however, the timeframe in which this must be done is very different for Corporations (which the University is considered) versus for Consumers. The applicable NACHA Rules relating to ACH returns are very specific, and state that Corporations (i.e. UC) would essentially have to notify the bank and request the return of a debit within one business day of receipt. Consumers, on the other hand, have the protection of Regulation "E" and specific NACHA Rules relating to Consumer accounts, which allow consumers to return ACH debit entries (that they document as "not authorized") up to 60 days after the original transaction date.

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Given the limited and strict timeframes in which the University, as a Corporate participant, must abide by, OTR has investigated bank services that would block unauthorized debits from posting to our bank accounts. While there are a number of different types of bank products that block or restrict ACH activity, these services generally fall into the following two categories:

- ACH Debit Block – This service automatically returns all ACH debits and/or credits that are directed to a particular bank account. No customer intervention is necessary once the service is set up.
- ACH Debit "Filter" – Automatically returns all ACH items for a designated account, except those that are pre-authorized. Authorized ACH Originators are identified by providing the bank with specific identifier information, e.g., originating company ID, individual ID number, etc. Some banks offer the flexibility of allowing customers to further fine-tune their payment criteria based on maximum dollar amounts, exact dollar amounts, and maximum number of occurrences.

Some financial institutions also offer ACH activity reports, showing ACH transactions that were returned through the blocking or filtering mechanism. There is also a service similar to "Positive Pay" that allows review of ACH debits before they are posted, with the customer making the decision to accept or return the debit individually.

The determination of which service to use is a function of what type of activity an account is used for and what specific debit block services are available from the bank holding the account. For example, it might be reasonable to block debits completely for a depository account, where a debit filter might be needed for a disbursement account. Our initial research with our banks indicates that all have some form of debit blocking available, but each has its own variation.

Generally, where the service is an existing bank product, implementation of these Debit Block or Filter services is relatively easy, with the execution of agreements and completion of set-up forms. Implementation of a Debit Filter would require knowledge of each Originator's (Payee's) Company ID. It would also require ongoing maintenance of this information