



ACH Rules & Regulations White Paper

This white paper discusses the increased security, rules, and regulations now applicable for all those using the nation's ACH network. It also provides detailed information on how to navigate through the compliance "mine field" now present, and how ACH processors can protect themselves and their clients.

Introduction

Many aspects of the business world changed forever on September 11th, 2001. In order to combat terrorism, the U.S. government has taken a multi-prong approach. Homeland Security not only protects U.S. airports and borders, but also the backbone of America's financial systems.

This white paper discusses the increased security, rules, and regulations now applicable for all those using the nation's ACH network. It also provides detailed information on how to navigate through the compliance "mine field" now present, and how ACH Processors can protect themselves and their clients.

Controlling the Money

When most people think of Homeland Security, and the role that they play, the average American doesn't see their efforts extend beyond the ones that are most obvious. They see firsthand, TSA agents at the airports, or the agents guarding our borders on TV or in the newspaper. Most people think that the efforts to combat terrorism are restricted to searching and finding weapons and bombs.

What the general population does not see is the other important approach taken to combat terrorism – verifying the legitimacy of the money moved through U.S. financial systems. By making it more and more difficult for terrorists and their supporters to move money around the banking system via new rules and regulations, Homeland Security and other government agencies have been able to squelch the funding life lines that allow these kinds of criminals to operate within U.S. borders.

New Trends

A trend of these new, stricter financial rules, is that they are constantly evolving, and steadily becoming more rigid over time. The effects of these new rules and regulations are now trickling down from U.S. banking systems to private industries. This is happening as the banking system adjusts to the new restrictions, and adapts to a more rule-based approach.

If you have been in the ACH business for a few years, you have probably become accustomed to loose rules governing ACH transactions, and very simple account setup processes at either your third-party ACH provider or your bank. You might also be accustomed to transmitting ACH items for payroll or collections customers with little or no regard to ensuring that your clients could pass muster with banks and the Federal Reserve. In a nutshell, these days are gone.

Now, the new ACH rules require yearly NACHA audits, and that proof be provided indicating that you absolutely know who you are doing business with. There are now very specific guidelines on what constitutes proof. For instance, your client is a lifelong friend, but you cannot produce a specific type of documentation about that client when requested. You now risk large fines, and in a worst-case scenario, risk the loss of ACH privileges all together.

In 2011, the biggest changes that swept the ACH industry and separated the ACH players between long-term survivors and eventual casualties was due to two new compliancy requirements / regulations: Yearly NACHA Audits, and "Knowing Your Customer."

Yearly NACHA Audits

The first major compliance requirement for any third-party ACH Processor is now to complete a yearly NACHA Audit. This audit is mandatory for any company that is the closest originator to the banking system that has an individual agreement with each of the companies affiliated with the transmission. This is a difficult concept to explain, but it is crucial if third-party ACH Processors want to continue processing transactions for their customers through the ACH system.

If you are a payroll processor, you of course have agreements with each of your customers. But, if you want to avoid the complexity of the yearly NACHA Audit, you need to send your ACH/NACHA files to a third-party processor that also has an agreement with each of your clients. If you do this, you are not considered a third-party processor, and therefore not required to complete the audit.

By working with a properly-structured, third-party ACH Processor that has a contract for ACH processing with each of your clients, you are then considered an "Originator," and therefore not required to complete the audit yourself.

To avoid the audit, it is absolutely critical that you only process through an third-party ACH Processor that:

1. Has a one on one contract with each of your customers that includes language authorizing the third-party processor to process ACH transactions on their behalf.
2. Has a sophisticated processing system that meets the incredibly-technical requirements of the audit.

The yearly NACHA Audit is not for the faint of heart. System capabilities and requirements are a main component of this audit. Third-party ACH Processors are required to have an ACH processing system that is essentially as sophisticated as one used by a bank. These audits are usually comprised of a binder about five (5) inches thick, and contain audit proofs detailing the ability of an ACH system to store, retrieve, recreate, and redistribute any transactions processed for the last seven (7) years.

These NACHA Audits must also prove that the ACH system handled returns in the mandatory amount of time, and that those deadlines were achieved. You even have to be able to prove that all relevant information / funds was delivered successfully to the applicable customer.

Know Your Customer

The second major compliance requirement of “Knowing Your Customer,” is a direct result of tightened control over general banking, ACH transactions, and account holdings because of increasingly-high security concerns. The “Know Your Customer” now affects every aspect of banking.

The information that must be gathered from your customers has to meet specific criteria. Your records and documentation should show you that have made a due-diligent effort to certify and guarantee that your customer is indeed who they say they are. There is no grey area in this regulation. Just consider trying to open a bank account as an individual without a photo ID, or perhaps a business account without articles of incorporation, Tax ID, EIN, or business license. It can't be done. Now, the same steadfast rules apply to businesses that want to transact on the ACH network.

First-rate ACH Processors are currently being required by their partner banks to forward particular articles of information about new customers to prove that all of the “Know Your Customer” due-diligent documentation is in order. These requirements have begun to rapidly overwhelm third-party ACH Processors who do not have resources in place to handle the increased demand for documentation. Frustration, irritation, and inept reporting capabilities are either forcing processors to step up their game and upgrade their processes, risk heavy scrutiny and fines, or go out of business.

Chain of Trust

As the business closest to your customer, you have to prove that you “Know Your Customer” by giving your bank or third-party ACH Processor information about a business that is not easily gathered or known. This is the beginning of something known as the “Chain of Trust.”

Just like a bank that opens a checking account for you, they gather the “Know Your Customer” information, and other banks “trusts” that your bank has followed the rules. This means that you can write a check to a vendor who uses another bank, and not have to go through the entire “Know Your Customer” ordeal. Your bank has become the first link in the “Chain of Trust.” This is your responsibility as the first and closest ACH originator to your customer.

When your customer records are accurate, and fulfill the information requirements, you have identified yourself as a business worthy of the “Chain of Trust.” Remember, you know your customer better than anyone else. This is why a payroll processor with good and accurate records, who meet the regulatory requirements, thus provides a foundation of confidence for the rest of the businesses involved in moving your customer’s transactions through the ACH network.

When a business that creates and processes ACH transactions for other companies, like a payroll processor, has incomplete or inaccurate records, this break in the “Chain of Trust” causes the next entity in the ACH process to assume full responsibility as the closest to the customer. In most cases that is a third-party processor or a bank itself. This responsibility is assuredly something no one wants.

This is why the process of opening accounts with a respectable third-party ACH Processor can be frustrating. The ACH Processor can’t tell you your customers’ correct information, just like your bank won’t create a photo ID for you while you’re opening a checking account, then give it to you so you can use it to finish opening the account.

Requesting More Customer Information

Most payroll processing businesses have reservations about disturbing their customers with annoying requests for information. Unfortunately, a way has to be found to circumvent this concern and obtain all required information. If you don’t, you either have to gather the correct information yourself, or risk being denied access to the ACH network.

In a worse-case scenario, you may have to process through a third-rate ACH Processor which is a ticking time bomb. In fact, all over the country, processors are currently being dropped by their banks for failing to meet the two regulatory requirements discussed in this white paper. The business and income is not worth it to banks if it puts them at risk of scrutiny and censorship by the Federal Reserve. The hard truth is that a bank would rather get rid of you than end up having to defend you.

It is easier in the long run to go ahead and touch base with your clients and update your records with accurate information, rather than tell them that they won’t be getting their direct deposit. It’s also very easy for someone to do the homework and update their records on their own. You can go to the state or IRS website and update your client records yourself. Obtaining accurate, current information from your ACH Processor or your bank may leave you frustrated, but the rules are clear in that they cannot give you the corrected information. They are only able to tell you what’s wrong with the information, and do not have the ability or the authority to waive any requirements. If they do, be suspicious.

Required Information and Documentation

To pass the yearly NACHA Audits, and fulfill the “Chain of Trust” and “Know your Customer” requirements, current information, and proper documentation must be obtained so that banks and first-rate ACH Processors may accept and process transactions.

The requirements maybe divided into three areas:

1. Required Information:

- a. *Legal business name*
- b. *DBA (legal business name may be used if none is provided)*
- c. *Physical address of the business*
- d. *Business phone number (This must be a land line phone number. Cell phone numbers are NOT acceptable UNLESS the cell phone number is listed as the official business phone number on all legal documents.)*
- e. *Business fax number*
- f. *Taxpayer Identification Number (TIN) or Employer Identification Number (EIN)*
- g. *The name of the bank for the business account*
- h. *The business bank account number and the Routing/Transit number*
- i. *At least one (1) company principle (This must be the company owner or president’s legal name.)*
- j. *Business website address*

2. Required Documentation:

- a. *Documentation showing the business EIN/TIN. Accepted forms of this document are:*
 - i. *A government issued legal document with the EIN/TIN of the business*
 - ii. *SS4*
 - iii. *An IRS issued 941 for the business*
 - iv. *A Prepared 941 for the business signed by an external preparer (CPA, Accountant, etc.)*
 - v. *Business tax return for the business signed by an external preparer (CPA, Accountant, etc.)*

b. *Blank Voided Check. Check restrictions are as follows:*

- i. *If a new or starter check, a letter from the bank is required to verify the bank account number.*
- ii. *A computer generated check from blank check stock is not permitted. A letter from the bank is required to verify the bank account number.*
- iii. *The name of the bank that maintains the account in number 2 must be clearly shown.*

3. Information Verification Requirements:

The rules state that you must collect no less than six types of information from a business, and verify the accuracy of the documentation for no less than two. The verification information must be from a governmental body, or a licensed third-party information resource service.

Rule Details:

1. *The business address, legal name, and DBA should match the information returned by a governmental body (website) or a third-party resource.*
2. *The TIN/EIN and business name should match when processed through the IRS TINMATCH service.*
3. *The TIN/EIN status must be verified as active. Suspended, terminated, or inactive TIN/EIN information is not allowed.*
4. *The business phone number must NOT be a cell phone.*
5. *The business phone number must match the information retrieved from a governmental body (website) or a third-party resource.*
6. *The business must not have any outstanding judgments (i.e. UCC, Property, or standard Judgments).*
7. *The name of the business principles must match the principle names returned by a governmental body (website) or a third-party resource.*
8. *The type of business must be verified by a governmental body (website) or a third-party resource, and must not be on the list of prohibited business types (i.e. internet gambling, internet cigarette sales, credit repair services). The prohibition against certain businesses is strictly enforced. A reputable third-party processor must verify that the business has a viable product or service, and is not a get-rich-quick scheme. The fines for transacting business via the ACH network of a proscribed business type are serious.*

Risk Mitigation / Financial Losses

Some payroll processors might be inclined to find an ACH Processor that does not enforce the new ACH regulations. Beware! They are forcing the compliance issues down to you instead of shielding you from them. There is no free lunch or get out of jail free card with regards to the strict compliance rules. Don't get stuck with a third-rate ACH Processor, and become a payroll service provider that all of the sudden finds themselves without a bank, or a way to transmit ACH items.

A first-rate ACH third-party processor that adheres to all rules and regulations provides their customers with piece-of-mind. They will do all of the hard work to make sure that their clients don't incur losses from fraud or shaky businesses. First-rate ACH Processors should act like a business partner, not like another average vendor, and guide you through the compliance mine field.

More Information

To further discuss the material in this white paper, and get more information, please contact:

Steven F. Pereira
Vice President / General Manager
National Payment Corporation (NatPay)
813.222.0333 x151
stevep@natpay.com

Copyright and Disclaimer Notice

All information in this document is subject to copyrights owned by National Payment Corporation (NatPay). Any reproduction, retransmission, republication, or other use of all or part of this document is expressly prohibited, unless prior written permission has been granted by NatPay or the appropriate copyright owner. All other rights reserved.

The names, logos, trademarks, and service marks of NatPay that appear in this document may not be used in any advertising, publicity, promotion, or in any other manner implying NatPay's endorsement, sponsorship of, or affiliation with any product or service, without NatPay's prior express written permission.

In the preparation of the information contained in this document, NatPay has endeavored to make that information as accurate and current as possible. However, inadvertent errors can occur. Therefore, the information in this document is provided "as is," without any guarantee or warranty of any kind, expressed or implied.

*Copyright National Payment Corporation (NatPay).
All rights reserved.*