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Association for Financial Professionals

VIA E-MAIL
October 20, 2003

Mr. Stephen M. Vajs
Director
Risk Management Division
Financial Management Service
U.S. Department of the Treasury
Room 423
401 14th Street, S.W.,
Washington, DC 20227

Re: 31 CFR Part 210
Federal Government Participation in the Automated Clearing House
Proposed rule with request for comment

Dear Mr. Vajs:

The Association for Financial Professionals (AFP) welcomes the opportunity to respond to the Financial Management Service's (FMS) request for comment on proposed amendments to 31 CFR Part 210 governing the use of the Automated Clearing House (ACH) system by Federal agencies. AFP will comment on amendments that address the circumstances in which checks presented or delivered to agencies may be converted to ACH debit entries.

AFP represents approximately 14,000 finance and treasury professionals who, on behalf of over 5,000 corporations and other organizations, are significant participants in the nation's payments system. Organizations represented by its members are drawn generally from the Fortune 1,000 and the largest of the middle market companies. Many of AFP's members have responsibility for the disbursement and receipt of check and ACH payments and for their organization's cash management operations. They thus have a significant stake in the adoption of policies that protect the efficiency and safety of payment systems.

FMS is proposing four amendments to its ACH rules to eliminate barriers to the wider use of check conversion to ACH debits by government agencies. These amendments would:

1. Shorten the length of the standard disclosure to check writers that their checks will be converted to ACH debits at lockboxes or drop boxes.
2. Allow use of Accounts Receivable (ARC) rules instead of point-of-purchase (POP) rules when checks are accepted in circumstances not typical of commercial point-of-purchase settings. ARC rules would allow checks to be destroyed rather than returned to the check writer.
3. Expand the definition of "business checks" and allow conversion to ACH debits at points-of-purchase and lockbox locations of additional financial instruments:
   (1) Any check drawn on a corporate or business deposit account, including a third-party check,
   (2) A credit card check,
   (3) A negotiable instrument issued by a financial institution (e.g., a traveler's check, cashier's check, official check, money order, etc.), and
   (4) A check drawn on a state or local government.
4. Allow the initiation of an ACH debit to collect a re-presented check (RCK) entry service fee if notice is given to the check writer before the agency accepts the check, instead of obtaining an explicit written authorization from the check writer.

Exceptions to ACH Rules

The U.S. payment system is very efficient, due in large part to the collaborative effort of corporate America, the banking industry, U.S. Government agencies, NACHA (the private sector rule-making body for the ACH Network), and payment-oriented organizations such as AFP. When the Federal government unilaterally establishes and thus mandates payments rule changes, it undermines this collaborative process and forces changes that may not be in the best interests of the payment system as a whole.

Three of the ACH amendments proposed by FMS are exceptions to NACHA rules. AFP considers a dual set of ACH rules—NACHA rules applicable to the private sector, Treasury rules for Federal agencies—burdensome to all payments system participants, confusing for end-users to understand, and operationally inefficient, error-prone and costly. AFP recommends that Treasury exceptions to NACHA rules be minimized rather than expanded.

AFP Opposes Business Check Conversion

AFP has long advocated and encouraged the migration from paper checks to electronic payments, which are safer, more efficient and cost effective. However, we opposed the U.S. Treasury Department's April 2002 decision to allow government agencies to convert business checks to ACH debits at points-of-purchase and lockbox locations, and we do not support the proposal to expand conversion to additional payment instruments.

Conversion of business checks to ACH debits disrupts corporate cash management practices, prevents automated account reconciliation, and circumvents fraud controls like positive pay. Bank systems that would avoid these disruptions have not yet been put in place. Most major banks do not have the capability of linking their check and ACH systems so that information can be communicated between them.

FMS does not include U.S. Government checks among the items eligible for conversion to ACH debits because of the potential for fraud. It is unclear why FMS does not feel that U.S. businesses as well as state and local governments—whose checks would be subject to conversion—would not have similar concerns about exposure to fraud.

Conversion of Additional Instruments

Operational inefficiencies

FMS states that conversion of additional payment instruments will reduce the operational burden on Federal agencies. AFP considers that, on the contrary, the proposed rules will introduce new operating inefficiencies whose costs will be borne by the government, businesses and financial institutions.

It is increasingly likely that business checks converted to ACH debits will be returned as the result of ACH debit blocks or filters on the accounts. In such cases, FMS states that it will use stored item images to create paper drafts. The following processing problems may result:

- If the replication of the MICR line on the paper draft is inaccurate or incomplete, the item may be rejected during check processing. This will cause further delay in the payment, require exception handling by the financial institution and the business, and prevent automated account reconciliation.
- Many companies block unsigned debits to their accounts. Paper drafts are unsigned, causing the payment to be returned a second time.
- Payee positive pay, a new and expanding fraud control service, may also block paper drafts. If the payee name on the draft is in a different location than the name on the original check, automated equipment may reject the item because the placement does not match the expected template.

Timely payments delayed

In a scenario likely to occur when business checks are converted, a timely business payment would be returned by an ACH debit block or filter, and again delayed or returned because of problems in processing the paper draft. These delays are not the fault of the business making an on-time payment. Yet the business could be assessed a late payment fee or have the date of the filing associated with the payment deemed to fall on a later date by the Federal agency. There is nothing in the proposed rule stating that a payment delayed under these circumstances would not be deemed to be a late payment.

AFP recommends that Treasury rules affirmatively state that the timeliness of payments will be governed by the date of the agency's receipt of the original item, not some later date if a paper draft is created. Only a uniform rule in Part 210 will ensure fair and equal treatment for all remitters to the many agencies that may utilize check conversion.

Payment instruments issued by financial institutions, such as certified bank checks, are heavily protected against fraud by ACH debit blocks and filters because of strict UCC liability rules. Both businesses and consumers use such payment instruments. If assessment of late fees or other possible penalties for a "late" filing are not barred when a delay follows an attempted check conversion, a proliferation of lawsuits can be expected against credit card companies, banks and other financial institutions by check writers assessed such fees or penalties.

Legal issues

FMS would include third-party checks among the business checks eligible for conversion, but does not define "third-party checks." There is no definition of a third-party check in either the Uniform Commercial Code (UCC) or the NACHA rules. FMS should clarify its intent in this case.

The proposed rule poses another legal problem. FMS recognizes that, in the case of certain negotiable instruments, the individual presenting such an item "does not have authority to act with respect to the account on which the check is drawn and therefore cannot authorize conversion."

FMS states that ACH rules "provide an adequate framework to enable a Receiver to pursue recovery of an unauthorized debit to the Receiver's account." However, the CCD code that FMS uses for business checks does not allow enough time for many businesses to determine the validity of these debits and return them. CCD return entries must be received by the originating financial institution no later than the opening of business on the second banking day following settlement of the original entry. This is in sharp contrast to the far longer period of time provided in the NACHA rules for POP and ARC entries.

Re-Presented Check Entry Service Fees

NACHA rules require explicit written authorization from the check writer in order for the payee to initiate an ACH debit to collect a returned check (RCK) service fee from a check writer's account. FMS proposes a "notice equals authorization" rule, that is, to allow Federal agencies to provide notice to check writers before accepting the check that an ACH debit will be originated to collect a returned check fee. Written authorization would not be required.

FMS states that it is not customer friendly to obtain a written authorization from every check writer because only a small percentage of checks are returned unpaid. The percentage of returned checks is likely to increase over time, however, with the government's increased use of conversion at an increasing number of locations.

NACHA also considered proposing a "notice equals authorization" rule to collect returned check service fees, but deferred proposing an amendment to its rules because of risk management issues related to unauthorized transactions. AFP recommends that FMS work with NACHA to investigate and evaluate the risk management issues involved, and avoid confusing consumers by creating two sets of rules.

Expanded Accounts Receivable Check Conversion Applications

FMS proposes to allow checks to be destroyed (using ARC rules) rather than returned to the check writer (as required by POP rules) when federal agencies accept checks in circumstances not typical of commercial point-of-purchase settings. For example, at remote Army bases or national parks, it may not be practical to set up equipment to scan and return checks.

As drafted, the rule is vague and fails to define the specific situations in which ARC rules would apply. This is another instance where an exception to NACHA rules would create confusion and potential resistance by consumers, contrary to FMS' stated objective.

Retailers considering check conversion at points-of-purchase undertake a cost/benefit analysis that includes logistical and operational feasibility before deciding whether to implement the process. Federal agencies should undertake a similar feasibility analysis and then implement the process according to NACHA rules or explore alternatives, such as stored value cards, depending on the specific circumstances.

Revised Accounts Receivable Disclosure

AFP recommends no changes to the proposed accounts receivable disclosure notice, which appears to be clear and understandable. As FMS notes, changes would be required if the above-mentioned expansion in ARC applications were to be approved.

AFP Recommendations

AFP understands and applauds the FMS objective to introduce greater efficiencies to Federal agencies' payments processing. In our view, however, the proposed amendments would not accomplish this objective.

- A dual set of ACH rules—NACHA rules for the private sector, Treasury rules for Federal agencies—is inefficient and costly for all payments system participants.

- Conversion of additional instruments would introduce new operating inefficiencies, resulting in increased return of timely payments, higher processing costs, and payer exposure to late fees or other penalties.

- A decision to permit "notice equals authorization" to collect a service fee for returned checks via ACH debit should be deferred pending evaluation of risk management issues in cooperation with NACHA.

- Exceptions to NACHA rules should not be granted for points-of-purchase locations in order to circumvent operational problems. If a cost/benefit analysis does not justify implementation under existing rules, alternatives should be explored.

AFP appreciates the opportunity to comment on these amendments to the rules governing the use of the ACH by Federal agencies. Please address questions about our position to Arlene Chapman at AFP, 301.961.8825.

Sincerely,

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