

## Accounts Receivable Conversion (ARC) for ACH

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Good day everyone. My name is Steve Bernstein. I'm the ACH product manager at J.P. Morgan Chase. Today we're going to discuss the accounts receivable conversion product for ACH known as ARC.

ARC items have been a fundamental growth engine for ACH since its inception in 2001. Today they constitute a large portion of volume in the U.S. for ACH processing. And indeed last year many billions of ARC items were processed. Let's talk about the definition of ARC and the eligibility factor. ARC items are used by our clients to convert checks at the point of receipt. That point of receipt can be a lockbox or a drop box that our client utilizes. With regard to the eligibility for an account receivable conversion or ARC transaction, they have to be \$25,000 or under, and they are typically a consumer based check. An item that has a MICR line where there is auxiliary on-us symbol is not eligible for ARC. A money order is not eligible for ARC. A large corporate transaction is not eligible for ARC either.

That being said, many transactions in our everyday lives are being converted from a check to an ACH or an ARC debit that occurs against our bank account. We see it in all walks of life from credit card to cable companies, telecommunications companies, and the like. Every industry has, to some extent, and in some cases nearly entirely, adopted ARC as a fundamental engine for which they process their transactions.

What are the reasons why businesses adopt ARC? For one thing, ARC items do not require an overt authorization from the customer to start processing. ARC transactions require a notification from the biller to the consumer that states that the item once received will be debited from their account as early as that current day of receipt, to convert that check into an electronic payment or debit to that customers account. So there's a fundamental difference right off the bat between an ARC entry and a non-ARC entry in the sense that you do not need an overt authorization, but merely need to provide notification.

That being said, the consumer does have a right to opt out. The consumer can notify their biller that they do not want to have their check converted, although recently that number is so small that it's merely a blip on the radar. Recently, NACHA has cited one-tenth of one percent as the opt out rate, which differs significantly from the inception of ARC back in 2001.

As a result, any business that looks to adopt ARC has a lot to work with, with regard to the frequency of payment in the sense that they need to provide that notification on each and every bill that is rendered to the customer. You cannot, in other words, send a one-time notification that indicates to the customer that you will then upon receipt of the check and the coupon convert forever more that ARC transaction. It does have to be sent from item to the item. As a result, we've seen ARC grow from business to business, from industry to industry, and let's talk about some of the rationales as to why.

First of all, there's a difference in terms of eligibility where in some cases if you are a business — a consumer driven business, a good proportion of your transactions will be converted into ARC items. That proportion of ARC transactions translates typically into better availability of funds for that business. In most cases transactions that are on-us can be provided same day availability, and those that are off-us can be provided next day availability.

Recently, the Federal Reserve has announced a new rule concerning same day off-us activity, known as same day ACH. The coming years will see the impact of that rule change as it impacts our clients who's purpose is to accelerate

the availability of funds and adoption of entries such as ARC for payment processing. Right now though let it be said that most on-us transactions receive same day availability of funds, and most off-us transactions receive next day availability of funds. That being said, it is still a better ratio for electronic than it is for paper.

Secondly, in most cases ACH is a cheaper alternative to check or other payment options. And that results in real benefit to the biller.

Thirdly, the overall reduction of exceptions or returns also plays a positive role in the business adopting ARC. The rapidity in which a return item will occur in an ARC transaction stands in stark contrast with check in the sense that an ACH item on average is received back by the biller between one and two business days after settlement. As a result, that biller can disposition those transactions and act on them, and in certain cases and in certain industries, those industries have reaped the benefit of reducing their fraud and other types of negative connotations that results from checks and the float from those checks being processed. Once moved into an ARC environment those billers especially in the credit card arena are able to reduce their outstanding float as well as their potential fraud significantly. In some cases, we've had business cases cited by our clients that have stated that in and of itself, the fraud reduction from converting to ARC paid for itself many times over with regard to the expenses that were engendered from making that change.

So let's talk about the payment process. Chronologically, the consumer receives a bill from the biller. The consumer mails a check along with a coupon back to the biller. What happens from there? The biller then receives the check either in their lockbox or if they choose to outsource the lockbox, they will run the check through their engine to process the item. The biller can at that point determine whether or not they will either send an ARC file in a separate deposit or Image Cash Letter file once they've done their validation and once they've run the eligibility check on those checks. They could choose to do this in-house, or they could choose to send an all Image Cash Letter file where J.P. Morgan will decision that item in terms of its eligibility and then process those transactions accordingly.

As we stated earlier, in many cases the proportion of transactions in a consumer facing business can approach 75 to 80 percent or more of the overall transaction activity, and be provided the availability of funds accordingly. Once those checks have been processed, typically they're denoted as being processed as ARC and their imaged, and they're either held as an image by the biller or the biller outsources the image access to someone like J.P. Morgan to store on their behalf. Those transactions, if they are required, can be researched after the fact in the event of a return. In most cases, we see a significant drop off of exceptions with regard to ARC. The fact of the matter is that on an everyday occurrence, if somebody is writing approximately 15 checks a month, there's a good chance that a good proportion of those transactions are being currently converted to ARC today. And as time evolves, more and more of those transactions will be converted to ARC in the future. We see billers from every walk of life exploring or looking at deploying or deploying ARC as a means in which to make their business more profitable, to reduce costs, and to expedite the payment process. We see that ARC has been a winner in conjunction with other types of ACH activities. For example, at the inception of the ARC program, the fact of the matter is that the consumer is mailing a check and paying for a stamp with which to send their payment and the coupon back to the biller with. We've seen a fundamental shift away from check writing once an ARC program is adopted, whereby that payment which was once ARC is now being sent either via a Web transaction, where the consumer goes right to the billers site to make a one-time Web payment, or through online banking. So we see a transitional phase in conjunction with the reduction of check writing along to other payments types where the consumer in effect will not be charged the rate for a stamp. And as we see postal rates go up in the future, we see that incidence recurring with more rapidity.

In terms of the payment process, the idea that ARC is a significant proportion of ACH activity is one that will continue over time. All be it a foundation block with which we will work with our billers to fashion the best solution for them. In terms of the overall options, we understand that we can perform the decisioning on behalf of our client. Our client can send a payment file, what we call an Image Cash Letter in its entirety, or they can make the decision in-house. The key to the situation is that you have flexibility with regard to the solution. J.P. Morgan can work directly with the biller, or if the biller outsources their lockbox we have many relationships with other lockbox processors whereby we can process the ARC transaction and provide a solution for payment processing.

Let's talk a moment about some of the unique qualities that we have within our ARC program. The first one is what we call ZAR, or the Zero Administrative Return database. In conjunction with ARC, we provide this as a service where simply if we receive an administrative base return for an ARC transaction, we will truncate that item at J.P. Morgan and not send the information or the issue back to our client. We will process the item ourselves, research it, and correct it through our Zero Administrative Return tool. This tool has tens of millions of transactions on it where we know the endpoint, ABA and/or account number with which to convert the payment to. What this does is that it enables us to correct the transaction and resubmit it on behalf of our client. In some cases the item was returned for an administrative reason because there may have been a transposition of the account number due to a blurry image of the check, or it

may have picked up dirt on the camera lens, which changed the account number, which created that administrative based return. In those cases, J.P. Morgan can look at the original image of the check, and then act accordingly in terms of correcting the item and resubmitting it. In the event that the item was sent for an incorrect dollar amount, we also have tools within our eServe process that allows our client to reverse or back out the erroneous dollar amount, and then resubmit the transaction for the corrected or new dollar amount.

The next tool that we have is known as the preemptive payment intelligent tool. This is a proactive tool that corrects the ABA and/or account number on behalf of our client's transactions before they go out the door. It uses our database, what we call a learning database, that takes and matches the information that we have from client data, matches it against the database, and if we have a match either on the account and/or the routing number, we make that change accordingly, and then send it out into the network. This is very key to reducing downstream returns, because in conjunction with our eligibility tool, and in conjunction with the payment intelligent tool, it helps minimize the returns that we receive at the backend where we would handle any administrative based return. All told, that leaves only what we would call a fatal return, meaning a final insufficient fund or closed account return that we would need to send back to our client, and in effect reduces the overall activity and reconciliation that our client needs to perform.

The key that we hold true is that we provide a multitude of solutions with our client for handling the front-end aspect of these transactions. We provide tools in which to review historical based transactions for up to 180 days with the eServe tool, and then we also have correctability tools where we can correct items based on administrative based returns, or in the example cited earlier, for correcting an erroneous dollar amount for processing.

We believe our end-to-end solution is the strongest in the industry and that's reflected by the volumes that we process for ARC. Where we are the largest ARC processor and have been since the inception of it back in 2001. We continue to offer various solutions to our clients whether they initiate themselves through a third party as an Image Cash Letter client, or through other products that we support within our process, such as remote capture where we can also perform ARC transactions on behalf of our client.

If you have any questions about our process, please contact your customer service or your treasury management officer and we'd be happy to help you fashion a solution. Thanks, and have a great day.

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