

New ACH Rules and the Impact to Your Company

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Good day. This is Steve Bernstein, the ACH product manager for J.P. Morgan. Today we're going to talk about a subject that's been top of mind in the last year or so, and that is International ACH Transactions, or IAT. This was a new rule that went into effect on the 18th of September, but it's been a long time coming. What I'm going to do is explain how the rule came about, what the impact is on our client base, and how we best approach this as a team moving forward, vis-à-vis, any questions or deployment or any ongoing challenges that one may have.

First of all, the definition of an International ACH Transaction is probably the first issue that created some confusion. In actuality, IAT, or International ACH Transactions, ironically pertain to U.S. ACH payments. However, these payments, or these types of payments, have been defined by OFAC, or the Office of Foreign Assets Control, as a payment that will at least subsequent to the initial payment, move cross border, and as a result, need additional data requirements that's consistent with the Bank Secrecy Act, or BSA, travel rule.

And what that means in layman terms is that payments that are made to either an employee as a disbursement as a business as a disbursement or if funds are being collected from an individual or a business, depending on the definition of what IAT constitutes, vis-à-vis, OFAC and the Bank Secrecy Act, our client, our originator, may have to change the way in which they send their payments to J.P. Morgan so that they can be transacted through the network.

As a result, this additional information allows us at J.P. Morgan either as an originator, or a receiver, to apply OFAC controls to a given transaction. So in summary, this rule was impacting the U.S. ACH. It is defined as an International ACH Transaction, and additional information or data requirements have to be sent with the transaction.

So let's talk a little bit about what IAT constitutes; how to define an IAT, and how our clients would go about deploying it.

Effectively, an International ACH Transaction is either an ACH credit, or an ACH debit entry that is part of a payment transaction that involves a financial agency office that is not located within the United States. And that financial office is involved in the payment if it either holds an account that is credited or debited as part of the payment. It's received directly from a person or makes a payment directly to a person as part of a payment, or that financial office serves as intermediary in the settlement of any part of the payment transaction.

Now, from a fundamental standpoint, an example would be, if we have an originator or a client of J.P. Morgan that is looking to make a direct deposit of payroll transaction to one of their employees, and that employee works at XYZ Company, and they have an office in Paris. That office in Paris sends the employee to the United States for six months. That employee opens a bank account at a bank in New York. When that employee is paid as direct deposit in New York, they move those funds in their entirety to their home bank in Paris through a different transaction. It could be a wire, et cetera. Based on the definition of an International ACH Transaction, our client, if they continue to initiate direct deposit for that employee, will have to add additional data fields to that transaction and send that transaction now as an IAT, or International ACH Transaction.

We, at J.P. Morgan, would have to test with our client. The options that our client has for initiating an International ACH Transaction are either directly as part of a payment file, or an ACH payment file, or through J.P. Morgan ACCESS, which now, as of November 17th, can affect IAT transactions, or through PaySource. Through those three

methodologies our client can initiate these additional data requirements with IAT, test with us, and we can deploy that payment for IAT. We, at J.P. Morgan, have the responsibility of validating the transaction through OFAC rules. So we effectively scrub the payment file through OFAC, based on their determinants, the item will pass through OFAC, be processed through the ACH as normal with this additional information, on route to the receiving bank and then posted as usual. However, if there is reason for concern, or if this is an exception on the OFAC list, there is the possibility as there is with wires, that the payment could potentially be held up or in some cases impounded for further review by OFAC.

We, as a bank, have an obligation to report based on our requirements any item that would in effect be what we would call a positive hit for a transaction with OFAC. Further, the additional information that is required will cause our clients to go out to their customer and obtain the additional information so that they can populate what in effect will be seven additional addenda within the payment.

An example would be for that same direct deposit of transaction that was made previously without IAT, there were no addenda with that payment. With IAT there are seven addenda fields, and addenda constituting 80 bytes of information that have to be populated with information relating to the bank where the payment is routed to, the postal code information of that bank, and further information as befits the travel rule pertaining to the bank where the money transmitter, or the financial agency involved in the transaction, is located. Which then also requires our client to validate that information with their customer.

In another example, if our client is collecting funds from a vendor, and that vendor is funding the entirety of that transaction from outside the United States, then that transaction would also constitute an IAT, or International ACH Transaction. In the prior example, if the employee is moving the entirety of their direct deposit out of the U.S., then that would also require an IAT. And the key is that the entirety of that payment, of that direct deposit, if being moved out of the United States to another country.

In the vendor collection example the vendor is funding the entirety of the payment from outside the U.S. So the key is that word entirety. If the funds are not being funded in their entirety, if the direct deposit is not being moved in its entirety, then by definition with the rule, it is not an IAT, and that's an important distinction to make.

Further, we have developed in coordination with NACHA, the National Automated Clearing House, a new authorization document that would be used with regard to any authorization for an ACH collection, or an ACH disbursement that they can supply to their employee or to their business or vendor partner, that asks further questions from the current authorization that includes information and data on behalf of our client. So that they can use that as a means in which to define whether the transaction is IAT or not IAT.

Another example that many of our clients have used is looking at their databases to determine how many addresses of their customers, of their vendors, of their employees, how many home addresses exist outside of the U.S. And although not being the total determinant as to whether the item would be an IAT, it is certainly assistive to prompt further review as to whether the transaction could in fact be an IAT transaction.

Another way that our clients have come to find whether or not they have IAT transactions is simply the fact that this rule is now in effect as of September 18th. We've had clients receive return items or notifications of changes that direct them to the fact that the transaction that they initiated as a simple ACH is now an IAT and must be sent according to the IAT rules.

That being said, many of our clients have looked at the way they send payments, and have tried diligently to identify how many and what proportion of their payments would constitute International ACH Transactions. Meaning that they move across border after payment, and in some cases, if that volume of transactions is exceedingly low, then it prompts the originator to potentially not continue to send an ACH transaction through the system, but use another alternate payment method such as wire or check that is not impacted by this rule. Although it must be said certainly ACH being the lowest cost payment type to introduce a wire, which also has OFAC rules, and more costly, or a check, which has its own challenges with regard to cost and fraud potential, will make our client think twice perhaps as to whether they should either deploy IAT or on an exception basis deploy an alternate payment method.

What we're saying is that this should be a collaborative effort with regard to our clients to determine how to define what an IAT is, and how to deploy and whether to deploy IAT based on the volumes or proportion of those transactions, and whether or not it makes sense for you to deploy IAT.

With regard to the support mechanisms that we have, our ACH product management team, and your treasury management officer, stand ready to support any support that you require with regard to identification purposes, implementation, and ongoing support.

We have monthly webcasts with regard to our entire client base. Come one, come all, to discuss what International ACH Transactions are and what they mean, and we will continue to do them in the months ahead throughout 2010.

In addition, if there's any individual conference call or meeting required, we're happy to support that to discuss what IAT constitutes. The fact of the matter is that with IAT and OFAC, there are severe punitive penalties that our clients may absorb with non-compliance. OFAC has the wherewithal to fine our clients up to 10 million dollars for non-compliance with these rules. So we are, of course, taking this very seriously. But the fact of the matter is that this rule has engendered a great deal of confusion with our client base, and with the additional addenda records that pertain to additional information it's provided our clients and ourselves with a challenge of meeting what this rule constitutes.

That being said, we do not anticipate a large proportion of these transactions being IAT, with the exception of our clients, our financial institution clients, overseas that either have a large expat population, or that are making pension payments outside of the U.S., or that have funding that occurs from outside of the U.S. Other corporations, other FIs that we work with should have a fairly low proportion relative to their client base that they utilize for ACH.

The growth of ACH in 2009, for example, will potentially reach 20 billion transactions. Our best educated guess for the proportion of transactions that would result in being IAT for those 20 billion transactions is slightly less than 10 million so certainly much less proportionally than the entire populous of payments. However, we've had clients that have asked the question, would it make sense to initiate all of my transactions as an IAT, and we've tried to inform our clients from a financial standpoint, it would not be the best methodology of deploying IAT, because not only would it be more costly for our client, but it would compel them to research and find additional information and make additional requirements that may not be necessary. Meaning that in some cases it's just as egregious to go overboard on these rules than it is not to comply. And so we encourage our clients to work with us to identify specifically those transactions that would be IAT.

So in summary, the three methodologies that our clients can utilize to identify whether they have International ACH Transactions or IAT are to work with us relative to what the rule constitutes, again a credit or debit entry that is part of a payment transaction that involves a financial agency office that's not located within the U.S. Work with us to identify either through the addresses that you have on your payment files based on the rules with regard to authorization, and based in practice by the ongoing return item processing that occurs with regard to IAT today. We know that there are several banks, especially in Canada, that have adhered rigidly to IAT, for example, The Bank of Nova Scotia, and the Royal Bank of Canada. As 2010 evolves we expect that many other banks that have or maintain branches within the U.S., such as New York, California, and Florida, may step up the process of identifying such transactions and could potentially impact our client base.

In the meantime, our clients can work with us to identify those routing numbers that have been defined as IAT. In the event our client receives a return item in practice for an IAT, they will usually revolve around the specific reason code of R17. Within that reason code it will define for our client the fact that, that transaction should now be initiated either as an IAT, or directs our client to move to a different payment type in order to avoid potential penalties.

We look forward to working with our client base to further identify, implement, and deploy IAT, as this has been a challenge that I think we've met successfully so far. But come 2010 we expect there will be a redoubled effort with regard to deploying and adhering to these rules as it applies to the definition of International ACH Transactions.

Thank you.

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