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Viewpoint: Direct Send Pacts Threat to ACH System

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By George Thomas

The banking industry must begin to recognize the embryonic threat to the automated clearing house network that could ultimately cripple the most powerful U.S. payment network.

The ACH network has extensive reach (every financial institution in the United States participates), and therefore it provides access to every banked consumer and every business customer. No other single electronic network has the reach of the ACH. This is a significant advantage.

Also, the ACH network is the only payment system that handles a wide variety of credit transfer applications as well as debit transfer applications.

What exactly is the threat? An increasing number of direct send (bilateral exchange) relationships are now developing among the largest ACH players, driven primarily by the large credit card processing banks.

They are looking for better settlement times that provide quicker fund availability and earlier returns for credit risk management — same-day ACH. These initiatives are developing because the ACH network has failed to meet the needs of the market.

The creation of value-added functionality for debit transactions is an absolute necessity if the ACH network plans to remain competitive with the check clearing system.

While working for the Electronic Payments Network in 2003, I proposed same-day clearing for accounts receivable conversions with a value-added pricing component.

Five years later the market is moving to that model, unfortunately bypassing the ACH network. Once bilateral connections are established, there is no logical reason not to include other transactions in a same-day or next-day exchange model.

Bilateral exchanges are very inefficient, and they are the primary reason clearing networks were developed in the first place.

A direct send arrangement may lower transaction processing costs in the short term, but it results in a number of complications and inefficiencies. Connections must be established with each exchange partner. Individual accounting between banks and risk management must be addressed, along with the one-off settlement, which is usually accomplished with a wire transfer. There are operational problems such as communications issues, late filings, and untimely editing of the originator's file; reduced liquidity; and uncertainty about settlement timing and when the wire transfer will be received.

Bilateral exchanges benefit the processing banks but provide no significant benefits to the network or to the network operators, consumers, companies, and government entities that use the ACH network. In fact, these exchanges will cause the following significant damages to the network.

- A loss of ACH operator revenue, which will impact unit cost for all remaining in-network transactions.
- A loss of Nacha revenue for administering the rules and risk management functions.
- Higher prices for in-network items.
- Increases in pricing for smaller institutions and in the cost to reach these institutions.
- A reduction of ACH participant protections due to the lack of adherence to Nacha rules.
- An inability by the network to monitor billions of transactions for illegalities and telemarketing abuses.
- The potential elimination of one of the ACH operators, reducing contingency options, fee competition, and network product innovation.

Wells Fargo and Bank of America have joined forces to operate a combined ACH platform for both companies and their clients. In May they created a limited liability company, Pariter Solutions, which will by some counts be the country's largest processor of ACH payments. It will include a bilateral exchange of ACH transactions between Bank of America and Wells Fargo.

Pariter has the potential to add other large ACH players to its platform, as well as accommodating a variation of the typical direct send relationship that exists today.

The ACH network should develop strategies to deal with these inevitable threats. If it doesn't evolve, a few large originating and receiving banks or nonbank entities will create their own initiatives, eliminating the benefits that the ACH network provides to all stakeholders, consumers, businesses, government, and financial institutions.

Mr. Thomas is the principal of Radix Consulting in Oakdale, N.Y. He is a former executive vice president of The Clearing House Payments Co., where he managed the payments division.