A Looming New Risk for Financial Institutions: International ACH

By George F. Thomas

Community bankers be forewarned: today's Office of Foreign Assets Control (OFAC) compliance standards, requiring banks to block transfers to or from an account on its books if that entity is on the Specially Designated Nationals (SDN) list, will get more complicated when NACHA's International Automated Clearing House (ACH) Transactions rule takes effect in 16 months.

Right now, complying with the OFAC regulations for ACH transactions is fairly simple. The OFAC expectations regarding the processing of transactions involving countries under sanctions are clear. Financial institutions are required to report all blocked transactions to OFAC within 10 days of occurrence. Failure to comply could expose a financial institution to adverse publicity, fines and even criminal penalties.

NACHA's announcement to implement the International ACH Transaction rule significantly changes the cross border landscape for every U.S. financial institution. Starting March 20, 2009, the Federal Reserve International ACH service will permit, for the first time, inbound credit transfers from Europe, Mexico and Canada. It will now be the responsibility of the Receiving Depository Financial Institutions (RDFIs) to screen all of the information in an International ACH Transaction for OFAC compliance.

International Rules

The new NACHA rule clearly defines, for the first time, what constitutes an International ACH Transaction: the location of the originating party that initiates the payment transaction. More

OFAC's Role

The Office of Foreign Assests Control administers a series of laws that impose economic sanctions against hostile targets to further U.S. foreign policy and national security objectives. The success of these sanctions requires active participation and support from every financial institution. The use of sanctions in the United States goes back to the earliest days of the Republic, through trade embargoes, blocked asset controls and other commercial and financial restrictions. Many of the sanctions have been accepted within the global community against pariah countries. Sanctions also are being used against groups, such as narcotics traffickers and terrorists, who threaten the security, economy and safety of the United States.

specifically, an "International ACH Transaction" is an ACH transaction for which at least one processing financial institution or third party is domiciled in the United States, and at least one party to the transaction is outside U.S. jurisdiction or, it's a transaction initiated from an originator outside of the states with the ACH funds transfer taking place between two domestic financial institutions. An example of this would be a message sent over the SWIFT network.

Thus, certain transactions currently formatted as domestic transactions, but are in fact international transactions, will need to be sent as International ACH Transactions. The new rule also requires originating financial institutions to supply a substantial amount of new information about the originator and the beneficiary.

The inclusion of the "Travel Rule" information—including originator name, address, account number, originator's depository institution name and payment amount, beneficiary name, address, account number and the beneficiary's financial institution—will help RDFIs with the screening. With the new information, international ACH transactions will require the same OFAC screening techniques as wire transfers.

The "Travel Rule" information will be contained in addenda records of the ACH transactions requiring ACH operators, financial institutions and providers of ACH software to make extensive changes to accommodate the International ACH Transaction requirements.

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Changes for RDFIs

Once the new rule is implemented, RDFIs must screen every International ACH transaction they receive against the OFAC's specially designated national list. Transactions that are identified as suspect must be thoroughly investigated. A financial institution that suspects that information in the transaction matches information in the OFAC SDN list must immediately freeze the funds and report the transaction to OFAC for final disposition.

This will be the first time that RDFIs will be required to screen incoming international ACH transactions for OFAC compliance. Very few RDFIs have the tools in place to perform OFAC screening for ACH transactions today, and it is clear that they will need to invest in the proper tools and trained personnel to screen these transactions.

OFAC has a reputation of working with financial institutions that miss a transaction that should have been blocked if the financial institutions had the proper procedures in place. However, OFAC has very little tolerance for financial institutions that have not taken the appropriate steps to ensure compliance with regulations. The noncompliance risks are substantial and should not be taken lightly.

Bearing the Burden

The NACHA International ACH Transaction rule makes it incumbent on all financial institutions to acquire OFAC screening

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software tools or a service provider that will offer the screening service. A screening package for a large institution can cost up to $250,000. Conservatively speaking, a typical package or service offering would be $5,000 per institution or $65 million for the industry ($5,000 x 13,000 institutions), not including the cost of software changes for ACH operators, originating financial institutionsand receiving financial institutions.

Centralized OFAC screening services should be offered by the ACH operators, the Federal Reserve Banks—FedACH and the Clearing House Payments Co.—Electronic Payments Network (EPN). It's more practical and cost-effective to have a centralized service from the operators than for each institution to search for and acquire a unique solution. Centralized screening would produce high-quality results and would be uniform across the industry. EPN offers a centralized OFAC screening service that will have to be modified to meet the new requirements. The Federal Reserve should offer a similar service, because the main beneficiary of international ACH is the FedACH International Service.

Now is the time to determine what approach to take. Finding the right solution to fit the bank's needs is of primary importance. This new application will add a new compliance requirement, and if it is not addressed appropriately, it can have dire consequences for a financial institution. ib

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