**MANAGING ACH RISK:
BEST PRACTICES**

*Presented by:
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Kelly Kiker, Bank Plus*

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AGENDA

▶ **Introductions**
  – Kelly Kiker
  – Brent Siegel
▶ **Managing ACH Risk –Best Practices**
  – Policies
  – Procedures
  – Tools
▶ **What are the Risks? Where are the Risks?**
  – Financial Health
  – Fraud
  – 3rd Parties
  – Business Practices
▶ **What are the Best Practices you can implement now**
  – Assessment
  – Underwriting & Onboarding
  – Modeling
  – Tracking & Monitoring – Again
▶ **BankPlus Practices and Discussion**

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WHAT ARE THE RISKS – WHERE ARE THE RISKS?

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WHAT ARE THE RISKS? WHERE ARE THE RISKS?

- ▶ Underwriting unsecured loans
- ▶ ACH and RDC are recurring transactions – not a traditional credit
- ▶ Apple to Oranges – risk reserves?
- ▶ Depository/Credit Customer vs. ACH/RDC only
- ▶ Are we sometimes asking the wrong people to make the underwriting decision?
- ▶ Do we have the tools to risk rate and score the credit?

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WHAT ARE THE RISKS?

- ▶ Poor Financial Health
- ▶ Fraud, Account Takeover
- ▶ 3rd Party Senders
- ▶ Originators Business Practices

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WHAT ARE THE RISKS? WHERE ARE THE RISKS?

- ▶ Financial Health
  - – Credit Worthiness
  - – Business Health
  - – Payment Practices
- ▶ Tools
  - – Policies and Procedures
  - – Credit Reports
  - – Financial Analysis
  - – Account Review

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FINANCIAL HEALTH RISK BEST PRACTICES

▶ **Balanced Credit Reporting**
 – *There is no existing database of ACH/RDC Risk Metrics*
 – *There is no DNB or Experian for ACH and RDC*
▶ **The information you have on depository customers is superior to external sources**
 – *BUT - That is not the point*
 – *The point is that you can combine external credit and business scoring with a process to look at ACH and RDC in a consistent way*
 – *AND you can monitor these relationships*

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FINANCIAL HEALTH RISK BEST PRACTICES

▶ **Examine the credit data you have access to**
 – *Business Credit Scores*
 – *Payment History Scores*
▶ **Standard Documents – Taxes, Financials, etc.**

Credit Score	Business Health	Payment Consistency	Terms Consistency
Years in Business	Timely Payments	Timely Payments	Payment Trends
Employees	High Credit Offered	Increased Credit Offered	Increased Credit offered
Payment Records	Multiple Trade References	Trade References	More References
Past Due Records	Lawsuits, Liens, Litigation	Low Past Dues	Fewer Past Dues
Vendor Payment Volatility	Poor Industry trends	Legal Process Filings	Slow Payments
Amount of Legal Process	Challenging Geography	Days Beyond Terms	Increased slow or negative payment activity
Days Beyond Terms	Declining Business Scores	More Slow Payments	Fewer Trade References
Percentage of Slow Pays		Fewer Trade References	
Trade References			

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FINANCIAL HEALTH BEST PRACTICES

▶ **Collect the Standard Documents – Taxes, Financials, etc.**
▶ **Examine the credit data you have access to**
 – *Business Credit Scores*
 – *Payment History Scores*
▶ **Credit Reports**
 – *Credit Scores*
 – *Payment Scores*
 – *Recommend that you look at more than one source*
▶ **Additional Information**
 – *Lawsuits*
 – *Liens*
 – *Litigations*
▶ **News**
 – *Mergers and Acquisitions*
 – *Executive Changes*

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SCORING ACH AND RDC RISK

▶ **Combining business and transactional elements in a formal risk management program**
 – *Transactional Risk*
  ▪ Value
  ▪ Type of transaction
  ▪ Type of customer
 – *Business Risk*
  ▪ Underwriting the origination client
  ▪ On-going monitoring of that client

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WHAT ARE THE RISKS?

▶ **Fraud**
▶ **Corporate Account Takeover**
▶ **Tools**
 – *Policies and Procedures*
 – *Corporate Account Takeover Tool Kits*
 – *ID Theft Protection Plans*

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FRAUD BEST PRACTICES

▶ **Determine why the customer has come to your FI**
▶ **Identify sources and destinations of funds for all FI activity**
▶ **Assess whether a potential client is active in lines of business that are statistically more associated with unfair, deceptive or abusive marketing and sales tactics**
▶ **Require enhanced due diligence process – owners and officers personal credit reports**
▶ **Review internal requirements for high risk ACH customers: prefunding, balances etc.**
▶ **Determine if the customer uses multiple FIs for ACH**
▶ **Determine the nature of other relationships the Originator has within the bank**
▶ **Document steps taken to obtain and assess information**
▶ **Document their relationships with Originators and 3rd Parties**

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WHAT ARE THE RISKS?

▶ **3ʳᵈ Party Senders**
  – *Do you know their customers?*
  – *Should you?*
▶ **Tools**
  – *Policies and Procedures*
  – *3ʳᵈ party client list monitoring*
  – *Frequent reviews*
  – *Monitoring?*

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3ᴿᴰ PARTY ACH BEST PRACTICES AND POLICIES

▶ **Review internal requirements for high risk ACH customers: prefunding, balances etc.**
▶ **Determine if the customer uses multiple FIs for ACH services**
▶ **For Third-Party Service Providers and Third-Party Senders:**
  – *NACHA publication Third-Party Senders and The ACH Network for additional sound business practices*
  – *Track downstream organizations and review/assess each as if it were to a direct Originator*
▶ **Perform due diligence around regulatory, business and consumer issues:**
  – *Research with the FTC:*
  – *Research with the Better Business Bureau:*
▶ **Perform reviews of the business and principals**
  – *Utilizing independent third-party databases*
  – *Validate information about the business and its principals*
  – *Identify any judgments against or negative news related to the company and/or its principals,*
▶ **Research complaint websites**
  – *www.ripoffreport.com*
  – *www.complaints.com*

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WHAT ARE THE RISKS?

▶ **Business Practices**
  – *Business Types*
  – *Business Models*
  – *Industries*
▶ **Tools**
  – *Policies and Procedures*
  – *Monitoring*

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IDENTIFY ACH LINE OF BUSINESS BASED POLICIES

▶ **Define criteria for classifying ACH clients as High Risk**
  – *Industry classifications of specific concern to ACH:*
    ▪ Money Service Businesses (MSBs)
    ▪ Third party providers/processors
    ▪ Gaming, Adult entertainment
    ▪ Sellers of credit products
▶ **Identify classifications of specific concern to ACH:**
▶ **Do you have a standard set of SEC Codes, Payment Types**
▶ **Ensure that the nature of the transactions originated fits with the nature of the customer's business**
▶ **Review potential exposure limits**
▶ **Determine if they will typically exceed a certain threshold**
▶ **Review return rates and expectations for ongoing return rates**
▶ **Determine additional reporting requirements**
▶ **Determine frequency of monitoring and review of activity**

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BEST PRACTICES WE CAN IMPLEMENT NOW

▶ **ACH RDC Process Improvements**
▶ **Better Risk Assessments**
▶ **Better Identification and Categorization of ACH and RDC Risk**
▶ **Defining ACH Temporal Risk**
▶ **Calculate ACH Risk**
▶ **More Frequent Monitoring – Business and Origination**

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SUPPORT YOUR RISK MANAGEMENT PROCESS

Model – Forecast – Report

▶ Assess Risk and Approve the Relationship
▶ Set ACH Limits & Compile Metrics
▶ Identify ACH Risk and Timing - Assign Risk Rates
▶ Calculate Expected Risk
▶ Capture Actual ACH Volume
▶ Calculate Actual ACH Risk
▶ Evaluate ACH Risk Impact
▶ On-Going ACH Risk Calculations Monitoring
▶ Monitor ACH Risk Activity

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BEST PRACTICES

- ▶ Risk Assessment
- ▶ Underwriting & Onboarding
- ▶ Modeling
- ▶ Monitoring

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BEST PRACTICES

- ▶ Assessments
  - Initial and Ongoing
  - Comparatively
  - Data Gathering
- ▶ Tools
  - Tax Returns
  - Financials
  - Banking Relationships
  - Other Relationships
  - Credit Reports

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BEST PRACTICE: CATEGORIZE YOUR ACH AND RDC BUSINESS

- ▶ Organize/Classify your ACH and RDC Business Risk
- ▶ Risk and Transaction Size
  - Up to $10,000
  - Up to $25,000
  - Up to $50,000
  - Up to $100,000
- ▶ Risk and Customer Type
  - Low Risk: Utilities, School Districts
  - High Risk: MSB, Check Cashing
- ▶ Risk and Banked vs. Non Banked
  - ACH and RDC "only" clients have to be looked at differently – no data

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DEFINE ACH AND RDC RISK PHILOSOPHY "TEMPORAL RISK"

SEC	Risk % #1	Time frame #1	Risk % #2	Time frame #2
PPD – Credit	100%	2 days	0%	0 days
PPD – Debit	2%	2 days	0.5%	58 days
BOC – RDC	…?			
POP – RDC				
X9.37 – RDC				
POS – RDC				
CCD				
WEB				
TEL				

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MODEL AND CALCULATE ACH RISK

		Premise:	Customer Originates -	$	100,000	debits weekly			
				$	25,000	credits semi monthly			
			Estimated		Risk Expiration				
Date	Amount	Debit/Credit	Loss %	Days of Risk	Date		Risk Amount	Accumulated Risk	
1-Sep	$ 100,000	D	2.00%	2	3-Sep	$	2,000	$	2,000
3-Sep	$ 100,000	D	0.50%	58	31-Oct	$	500	$	2,500
3-Sep						$	(2,000)	$	500
8-Sep	$ 25,000	C	100.00%	2	10-Sep	$	25,000	$	25,500
8-Sep	$ 100,000	D	2.00%	2	10-Sep	$	2,000	$	27,500
10-Sep	$ 100,000	D	0.50%	58	7-Nov	$	500		28,000
15-Oct	$ 100,000	D	0.50%	58	12-Dec	$	500	$	30,500
						$	(27,000)	$	3,500
20-Oct	$ 100,000	D	2.00%	2	22-Oct	$	2,000	$	5,500
22-Oct	$ 100,000	D	0.50%	58	19-Dec	$	500	$	6,000
						$	(2,000)	$	4,000
27-Oct	$ 25,000	C	100.00%	2	29-Oct	$	25,000	$	29,000
27-Oct	$ 100,000	D	2.00%	2	29-Oct	$	2,000	$	31,000
29-Oct	$ 100,000	D	0.50%	58	26-Dec	$	500	$	31,500

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MODEL AND CALCULATE ACH RISK

Forecasted ACH Exposure Risk

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MONITOR THE BUSINESS ACTIVITY

YOU NEED SURVEILLANCE….
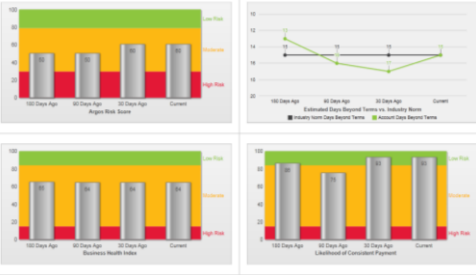
NOT A SNAPSHOT!

MONITOR THE BUSINESS ACTIVITY

Argonomics™ Trend Information

BEST PRACTICES

▶ **Tracking ACH and RDC Risk**
  – *Compare Expected to Actual*
  – *Frequent Comparisons*
  – *Actual Amounts compared to limits*

MONITOR THE ACH/RDC ACTIVITY

Credit Information

ACH and RDC Modeling

Business Trends over 180 days

BANKPLUS BEST PRACTICES

- **Kelly Kiker,**
  – *First Vice President and Director of Transaction Systems*
- **BankPlus**
  – *BancPlus Corporation is the parent company of BankPlus, which was founded in 1909 as Citizens Bank & Trust Company (CB&T), in Belzoni, Mississippi.*
  – *The name was changed to BankPlus in September 1994, when Southeast Mississippi Bank in Quitman was merged into the banking system, extending the BankPlus service area to southeast Mississippi.*
  – *BankPlus has grown from $156 million to over $2 billion in total assets.*
  – *60 offices in 33 Mississippi communities.*

MANAGING RISK – BEST PRACTICES

- ACH exposure Limits represents Unsecured Credit

- Financial Institutions are subject to loss due to the Unsecured Credit exposure

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STEPS TO TAKE TO PREVENT LOSS

- Perform annual underwriting on all ACH originators

- Risk Rate your customer

- Provide Daily reports of ACH origination activity to your Credit Department

- Subscribe to the Terminated Originators Database

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STEPS TO TAKE TO PREVENT LOSS

- Know your Customer's Business

- Monitor ACH Return items for high return rates **pay special attention to Third Party Sender activity

- Provide a monthly report of annual renewals due in the next 60 days. Continue to report renewals which have not been completed and are Past Due.

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RISK RATING

BankPlus establishes an annual Risk Rating for ACH Originators

➤ If the customer is an existing loan customer, the risk rating applied to the loan relationship will be assigned to the ACH Risk Rating.

➤ If the customer has no loan relationship, the Risk Rating applied will be based on the same Factors described in the Bank's Risk Rating System.

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RISK RATING

➤ The Loan Officer is primarily responsible for assigning, maintaining, and documenting accurate risk ratings for the term of the relationship

➤ Loan Officer approval level is based on the ACH limit requested – If the ACH limit is above the Loan Officer's unsecured lending limit, additional levels of approval are required

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RISK RATING

➤ The following are reviewed prior to establishing the risk rating score:

1. Balance Sheet Trends
2. Cashflow
3. Management
4. Guarantor Liquidity
5. Payment Performance
6. Product/Service
7. Outlook and Financial Reporting

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Managing Risk – Best Practices

What steps does your Financial Institution take to reduce the risk of loss?

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WHITE PAPER

*Identifying ACH Credit Risk
and
Calculating ACH Peak Risk*

By: Steven M. Foster
Founder and CEO
Argos Risk

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PUBLIC WEBINAR

*"5 Steps to Better ACH & RDC Risk
Management - A Case Study
Demonstration"*

May 23, 2013
10:30 – 11:05 Eastern

www.argosrisk.com/webinars

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CONTACTING THE PRESENTERS

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BEST PRACTICES

▶ **Modeling**
– *Temporal Risk*
– *Settlement Risk*
– *Credit Versus Debit*
▶ **Tools**
– *Acceptable Risk Profiles*
– *Risk Rates Tables*