



Guide to Internal ACH Origination for Credit Unions

Credit unions have traditionally been rather slow to begin or expand ACH origination services for several reasons. Most origination in the ACH system is submitted by large commercial banks on behalf of their commercial customers. This type of origination does involve some risk including credit risk and does require special procedures for handling security, exceptions, agreements, and exposure limits. Because of these risks and procedures, credit unions have tended to avoid origination – fearing the possibility of incurring more risk and a considerable amount of extra work.

However, credit unions can provide origination services to their natural person members (as opposed to business account members) without the risks and procedures required for most types of origination. We refer to this type of activity

Understand the difference between most types of ACH origination activity (external origination), and the internal origination applications we will review in this document.

as “internal origination”. These types of ACH entries submitted for your members will involve the credit union as both the Originator and ODFI (Originating Depository Financial Institution) of the entry, with your member as the Receiver.

In this scenario, the risks are very low, the procedures are relatively simple, and the work involved is very limited. Credit unions may also originate entries for their own cash management or settlement purposes.

The discussion below will cover these particular types of origination, and the processing requirements and options that credit unions should review.

Policies and Procedures

Before you begin offering origination services, we recommend that each credit union develop some written policies and procedures.

The policies should probably be limited to major issues such as which types of services will be offered (debits only, both credits and debits, etc) and whether any fees will be charged to members. Most credit unions do not charge for debit originations, but usually have a small fee for any credit originations. You may also want to address the issue of terminating origination service for a particular member in case of excessive returns or abuse, however I would recommend that any such policy be somewhat vague to allow for some management discretion in dealing with these issues.



Written procedures could address issues such as which employee or department is responsible for obtaining authorizations and processing entries, which authorization forms are used for a particular application, any deadlines or timelines for starting or modifying origination services, accounting entries and forms, return and NOC entry handling, processing of automatic terminations in loan payoff situations, and origination report production and retention. Training needs and compliance audit requirements may also be addressed in your ACH origination procedures, or may be handled by other departments within the credit union.

Types of Internal Origination Applications

- **Debits for Payment on Credit Union Loans** – Credit Union originates a debit entry to a member’s account at another financial institution, and applies the credit to a member’s loan at the credit union. These entries would only be used in situations where the member chooses not to maintain a deposit account with the credit union from which the payment could be transferred internally. The member can avoid having to send a check via the mail, and the credit union would therefore not have to process checks received in the mail. Some credit unions even give some sort of rate discount for these types of automatic payments to encourage members to use the service. In the event there are insufficient funds in the member’s account, the return entry would be received in a day or two as an ACH entry rather than the longer 5-7 days usually experienced with NSF checks. Telephone authorizations are popular for single entry debits used for late payment or collection type payments.
- Collecting loan payments is the most popular type of internal origination application at most Credit Unions, and is a very popular service for Credit Union members.***
- **Credits for Payment on Loans at other Financial Institutions** – Credit union originates a credit entry to a member’s loan account at another financial institution, and posts the debit to the member’s deposit account at the credit union. These entries would only be used in situations where

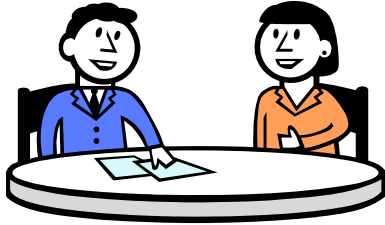
the member is unwilling or unable to obtain the loan at the credit union, and goes elsewhere to obtain the loan. The member could avoid having to send a check to the other financial institution to pay the loan. Some credit unions charge a small fee to provide this service. As an alternative, the member could ask the other financial institution to originate a debit entry to the credit union to withdraw the funds from the member's deposit account there.

- **Debits for Deposit to Member Accounts** – Credit union originates a debit entry to a member's account at another financial institution, and credits the member's deposit account at the credit union. These entries would allow the member to deposit funds to the credit union without having to write a check or make some sort of manual withdrawal from the other account. Entries could be done on a scheduled recurring basis with a fixed amount, or could be done as requested for variable amounts.
- **Credits for Deposit to Accounts at other Financial Institutions** – Credit union originates a credit entry for deposit to a member's account at another financial institution, and debits the member's account at the credit union. These entries would avoid the member having to send a check or wire transfer the funds. Entries could be done on a scheduled recurring basis with a fixed amount, or could be done as requested for variable amounts. Typical uses for these entries are for periodic dividend payments on certificates, scheduled IRA distributions, and as replacements for recurring transfers now done by wire transfer or mailed checks.
- **Credits or Debits for Settlement with Business Partners** – These entries are used to send funds to or receive funds from other businesses. They would replace transactions that now take place by sending or receiving checks, and the ACH entries would be both a faster and more efficient method than printing and mailing checks. Some examples of these entries might be for settlement with automobile dealers on an indirect lending arrangement, dividend payments to nonmember deposit holders, or invoice payments to providers of supplies or other services.
- **Credits or Debits for Cash Management Functions** – Credit unions send entries to transfer funds between the various accounts they hold at different financial institutions. The credit union would function as both the Originator and Receiver of the entry. Typically the funds are moved between local bank accounts used for check deposit or cash supply needs and the credit union's corporate credit union account. These entries can replace wire transfers in situations where same day settlement is not required. The cost for an ACH transfer is usually significantly lower than the wire transfer.

Authorization Requirements

The Receiver of the entry must authorize all of your origination entries.

Debit entries are usually in writing, but can also be obtained via telephone or the Internet if special procedures are followed. Copies of debit authorizations must be provided or available to the Receiver.



Credit entries are not required to be in writing, but are usually documented in some form simply to avoid mistakes or confusion.

Authorizations for entries with your business partners are normally included as part of your overall business agreement with them.

A sample authorization for use with your members is shown on the next page.

You can customize the authorization to fit your specific application, but it should always include the following at a minimum:

- Readily identifiable as a payment authorization
- Acknowledgement that entries must comply with laws of the United States
- Statement authorizing Originator to initiate credit or debit entries
- Account number and routing number of accounts
- Identification of account type (checking, savings, loan, etc.)
- Provisions for termination of the authorization, including any policies for automatic termination in the case of excessive returns or member abuse, or for automatic termination of loan payment debits when the loan has been paid in full
- Individual identification number
- Date and signature

Sample Form Only – Customize for your Specific Needs

AUTOMATIC PAYMENT / DEPOSIT AUTHORIZATION

I hereby authorize _____ Credit Union, hereinafter called CREDIT UNION, to initiate credit / debit (*circle one*) entries to my (our) account indicated below and the financial institution named below, hereinafter called FINANCIAL INSTITUTION. I (we) acknowledge that the origination of ACH transactions to my account must comply with the provisions of U.S. law.

FINANCIAL INSTITUTION INFORMATION:

NAME: _____

ADDRESS: _____

CITY/STATE/ZIP: _____

ROUTING NUMBER: _____ ACCOUNT NUMBER: _____

ACCOUNT TYPE: CHECKING SAVINGS LOAN (*CIRCLE ONE*)

PAYMENT INFORMATION:

STARTING DATE AND FREQUENCY: _____

FIXED DOLLAR AMOUNT: _____ OR VARIABLE AS REQUESTED (*CIRCLE ONE*)

APPLY TO CREDIT UNION ACCOUNT NUMBER: _____

This authorization is to remain in full force and effect until CREDIT UNION has received written notification from me of its termination in such time and manner as to afford CREDIT UNION and FINANCIAL INSTITUTION a reasonable opportunity to act on it. This authorization may be unilaterally terminated by the CREDIT UNION in cases of excessive returns or member abuse, or whenever any loans have been paid in full with recurring debits.

PRINT INDIVIDUAL NAME: _____

PRINT INDIVIDUAL ID NUMBER: _____

SIGNATURE: _____ DATE: _____

**** PLEASE ATTACH COPY OF VOIDED CHECK TO THIS FORM ****

There are special rules that apply for entries authorized completely via a telephone conversation with the member. These special rules only allow for a single debit entry using this authorization method. Recurring debit entries must still be in writing. The telephone authorization must either be recorded (preferred method), or a written confirmation of the authorization must be mailed or faxed to the member before debiting their account.

These special rules only apply to originating ACH debits. You can also originate ACH credits via telephone authorizations based solely on your internal policies.

In addition to gathering the routing number and account number information from the member during the telephone authorization, the following specific information must also be included:

- (1) the date of the member's authorization
- (2) the date on or after which the member's account will be debited
- (3) the amount of the debit entry
- (4) the member's name
- (5) a telephone number that is available to the member during normal business hours for inquiries about the transaction
- (6) a statement by the Credit Union that the authorization obtained from the member will be used to originate an ACH debit entry to their account.

Other requirements for telephone authorized debit entries include the need to verify the identity of the member, the need to verify the validity of the routing number given by the member, and the need to retain all authorizations (both written and telephone recordings) for at least 2 years beyond the date of the origination entry.

File Creation and Submission Options

There are several options for creating and submitting ACH origination files into the ACH system. All the options should have the ability to create standard NACHA formatted files, produce prenotification (test entries) if desired, create reports that include all file content fields and settlement totals, include security procedures or features to prevent fraudulent activity, and warehouse future dated entries for submission on the appropriate date. If a third party processor is utilized, a sending point agreement should define responsibilities and liabilities of

both parties, and at a minimum, bind both parties to comply with the NACHA rules.

The best option is to have the origination software integrated with your standard member account processing system. This arrangement makes it easier to locate



origination entry setup and transaction information, and would most likely provide the most efficient manner to post offsetting entries to member accounts. Offsetting entries are the other half of the ACH entry that need to be posted internally to member accounts. For example, if you send an ACH debit to withdraw funds from another institution for payment on a credit union loan, the internally posted loan payment credit entry would be the offsetting entry.

However, few of the credit union member account processing systems include a complete or reliable ACH origination package. Some systems offer no origination capabilities at all. Others can only generate a particular type of entry such as debits for loan payments, in which case another system would be needed to handle other types of entries. Many of these systems cannot generate single entry items – only scheduled recurring items. A few of them have been found to generate incomplete and therefore useless files.

Nevertheless, you should determine if your system has any ACH origination features, verify its capabilities with other users, and test the system thoroughly before using it in a live environment. If you do use your internal integrated system for creating files, you most likely will need to use another system for actually submitting the files into the ACH system – either directly to an ACH Operator or via a third party processor.

The next best option is to use a stand-alone software package or system which might include both file creation and submission capabilities. These systems typically have more origination capabilities but usually require that member information be manually entered into the system at the initial setup stage.

Offsetting entries can be submitted through the ACH system itself, or can be manually posted to member accounts on your internal system. The software is usually resident on your PC network or the Internet, and may allow access by your members – typically small business members – for their own origination needs. Files are delivered by these systems to an ACH operator or third party processor. Most corporate credit unions or other correspondent financial institutions provide these types of packages or systems.

SunCorp's APEX ACH System offers credit unions the ability to create and submit single or recurring entries for all types of ACH debit and credit applications.

Finally, if your origination volume is very low and your credit union has very limited computer capabilities, you might consider contracting with a third party processor to create and submit your entries. Typically, the credit union would mail or fax instructions to the processor to initiate, change, or cancel originations, and receive some sort of report detailing the originations after they have been submitted. Corporate credit unions or other financial institutions may provide these third party processor services. Due to the manual processing required in these arrangements, this option tends to be the least desirable and probably most costly on a per item basis. All the other options should be explored before deciding to use these types of services.

Accounting and Settlement

Internal accounting entries to both general ledger and member accounts will be needed for any ACH origination entries.

One side of the entry will be to your general ledger ACH settlement account which is typically an account at your corporate credit union. Since both origination and return entries are settled in the same manner, your settlement entry on your corporate statement may be a combination of both types of entries submitted on the same day. There will be separate debit and credit entries for the total amount of the originations sent each day.

The other side of the entry will depend on the method you use to post the offsetting entry to your member's account. If you send offsetting entries as ACH origination transactions, the other side of the entry would also be to your corporate account. In other words, you would make equal credit and debit entries to your general ledger settlement account. The incoming ACH entries would post to the member's accounts. If you have your system or your staff post the member account transactions, those entries would serve as the other side of the entry.

In any case, all the accounting entries need to be made on a daily basis, and hopefully, reconciled with your ACH settlement account records as soon as possible to detect any errors or omissions.

Exception Handling Procedures

Some of your origination entries may be returned to you by the Receiving Depository Financial Institution (RDFI) or the ACH Operator for various reasons. You may also receive Notifications of Change (NOC) entries requesting that you change some of the entry information before submitting it again. Although these types of exception entries are not very common, it is important that you follow proper handling procedures with these items. Since they are not encountered very often, credit unions can easily overlook them or forget how to handle them.

These exception items will be included in your incoming ACH transaction file and processed by the same software or system that normally handles incoming files. Since these transactions are not very common, most credit union systems are not designed to easily or clearly identify and report these entries, and few if any systems can automatically post them. Before you begin origination, you may even want to send some test entries to another financial institution, and request that they send you return and NOC entries in order to verify how your system handles them.



The transaction code on the entry will provide some information about the entry. Listed below are the most common transaction codes found on these exception items.

TRANSACTION CODE	RETURN OR NOC FOR:
21	Demand (Checking) Credit Entry
26	Demand (Checking) Debit Entry
31	Savings Credit Entry
36	Savings Debit Entry
51	Loan Account Credit Entry

You will need to determine which reports show these entries (usually on some sort of exception report from the posting program), and first determine if the items are valid. In other words, did the credit union actually originate the items in the first place. If the items were incorrectly misrouted to the credit union, they should be dishonored. Returned items that were received later than the deadlines allow should also be dishonored. If the items are found to be valid and timely, then make the appropriate accounting entry. This accounting entry will exactly reverse the original entry made when the item was originated. Some of the entries may be reinitiated depending on the reason for the return and your credit

union's internal policies. Listed below are some of the most common return codes and possible actions you might consider.

RETURN CODE AND REASON:	POSSIBLE ACTION BY CREDIT UNION:
R01 Insufficient Funds R09 Uncollected Funds	Reiniate at a later date to collect funds, or contact member for substitute payment
R02 Account Closed R03 Unable to Locate Account R04 Invalid Account Number	Contact member for corrected information and reiniate, or arrange for alternate payment method
R07 Authorization Revoked R08 Payment Stopped R10 Unauthorized	Contact member to obtain new authorization and reiniate, or arrange for alternate payment method

You may also receive NOC requests. The requested changes need to be made to the origination records before the entry is submitted again. The most common NOC codes are: C01 – Incorrect Account Number, C02 – Incorrect Routing Number, and C05 – Incorrect Transaction Code. The correction information will also be included with the change codes.

All the returns and NOCs received will reflect the transaction information from the original entry along with an addenda record that contains return codes, change codes, and any correction information.

Reversals / Requests for Return

If you submit erroneous ACH origination entries or files, the proper procedure requires that you send a reversal entry or file and notify your member of the reversal immediately. Reversals must be sent within 24 hours of discovering the error but no later than five banking days after the original entry. Your origination software should provide the ability to correctly format and create the reversal file with the proper transaction codes and descriptions.

If you are unable to create reversal files due to software constraints or missed deadlines, another possible method for correcting the error is to request a return from the RDFI of the erroneous entry. However, be aware that the RDFI is under no obligation to honor your request. If the RDFI agrees to return the item, you will probably be required to provide a written indemnification letter and an explanation for the return. The RDFI should use return code R06 – Return Requested by ODFI – in the return entry sent back to you.

Implementation Checklist

Internal ACH Origination



- **Research the potential demand for origination services**
Your member services staff, call center reps, and loan officers should be able to provide a good estimate of member interest

- **Obtain Board of Director approval and update policies**

- **Research origination software capabilities and contact SunCorp for information on the APEX ACH System**

- **Develop authorization forms and processing procedures**

- **Train internal staff on origination services and procedures**

- **Operate a pilot program with a limited number of members**
During the pilot program, you should test and review processing software, accounting and settlement, and exception handling procedures

- **If necessary, revise procedures and training using feedback and results from the pilot program experience**

- **Market origination services to members after procedures have been finalized, and staff is prepared to move forward**



This document is not intended to be an exhaustive discussion of all the issues and concerns concerning these types of credit union ACH origination entries. Hopefully, it addresses those issues that most impact your decision to implement or expand your origination services. We welcome your questions, comments, and suggestions for additional areas that need to be covered or others that need further clarification.