

EXECUTIVE SUMMARY

ORIGINATING PAYMENTS THROUGH THE AUTOMATED CLEARING HOUSE NETWORK

The Automated Clearing House (ACH) is a payments mechanism that replaces paper payments with electronic transactions. ACH transactions are processed through the ACH Network, a nationwide batch-oriented electronic funds transfer system governed by ACH Rules, which provides for the inter-bank clearing of electronic payments for participating financial institutions. ACH transactions are created by a company (the Originator) and are delivered to the Originating Depository Financial Institution (ODFI) or a third party processor. The sending point then electronically transmits the information to the Federal Reserve. ACH files are made up of batches, with each batch representing a series of transactions pertaining to one company and payment type.

Once the Federal Reserve receives an ACH file, transactions are sorted and transmitted to the Receiving Depository Financial Institution (RDFI) or its third party processor. These transactions are then posted to the Receivers' accounts. The Federal Reserve, which receives transactions from an Originating Depository Financial Institution (ODFI) or its sending point, distributes the entries to appropriate Receiving Depository Financial Institutions (RDFIs) or their receiving points, and performs the settlement functions for the affected financial institutions.

ACH NETWORK PARTICIPANTS:

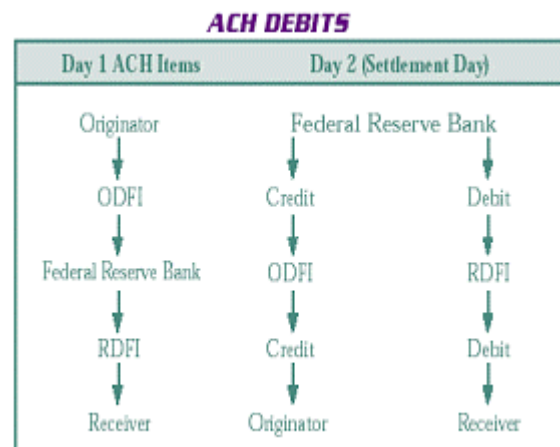
- An Originator is a person or organization that agrees to initiate ACH entries into the payments network according to an arrangement with a Receiver. The Originator is usually a company that originates an ACH item to a consumer's and business account. The Originator is responsible for obtaining and retaining any required authorization from the Receiver.
- Originating Depository Financial Institution (ODFI) is a financial institution that receives the payment instructions from Originators and forwards the entries to the Federal Reserve.

- Receiving Depository Financial Institution (RDFI) is a financial institution that receives ACH transactions from the ACH Operator and posts them to customer accounts.

- A receiver is a person and/or organization that has been authorized by an Originator to initiate an ACH entry to the Receiver's account at their RDFI.

ACH SETTLEMENT PROCESS:

ACH items can be debits or credits and the settlement for these items are processed on different days. An ACH item is processed on Day 1. The value of these items is settled on Day 2 or 3, depending on the type of ACH transaction. Additional, ACH items are classified as a debit or credit based on the settlement occurring to the Receiver:



Receiving Point:

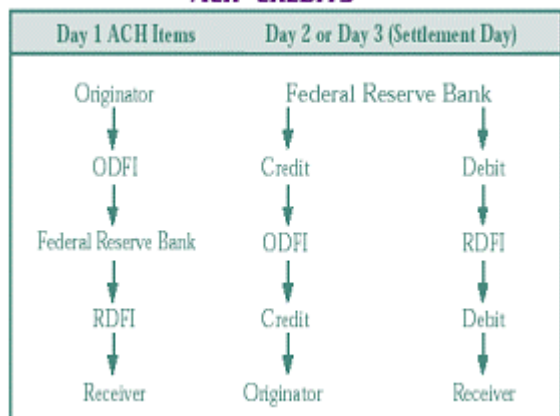
The point to which files from the Federal Reserve are delivered for the RDFI. A RDFI may designate itself or another entity as the receiving point.

Sending Point:

The actual point from which a file is deposited with the Federal Reserve for the ODFI. The ODFI may designate itself or another entity as its sending point, an ODFI may have numerous sending points.

EXECUTIVE SUMMARY

ACH CREDITS



ACH FILE STRUCTURE:

ACH files contain groups of ACH items in batches that must be in a specific sequence or the ACH Operator will not be able to process the file. Each ACH file header record (1 record) includes only one sending and receiving point; one of these always being the ACH Operator. Input batches, which are being sent to the Operator by the ODFI, contain items for multiple RDFI's. Output batches, which are coming from the Operator, contain only one RDFI.

ACH File Header Record:

Each ACH file has one File Header Record, which primarily contains ODFI information. Fields in this record include the local Federal Reserve routing number, sending point routing number, file date, file time, record block, Federal Reserve destination and the ODFI's name.

ACH File Batch Header Record:

There is one Batch Header Record for each batch of similar ACH items in an ACH file. ACH files can contain more than one batch. Depending on who creates the file, either the ODFI or the Originator will enter the data contained in the Batch Header Record. Fields in this record include the ODFI routing number, company name, company entry description (which prints on the customer statement), Originator identification, batch number, effective entry date, and standard entry class code.

ACH File Entry Detail Record:

An Entry Detail Record is an individual ACH item. The number of Entry Detail Records per ACH file can be up to 999,999 entry records per batch. Depending on who creates the file, either the ODFI or the Originator will enter the information contained in the Entry Detail Records. Fields in this record

include the dollar amount, the receiver's RDFI account number and name, the transaction code for the receiver's type of account, trace number, and RDFI routing number.

ACH File Addenda Records:

The Addenda Record is an additional ACH record connected to the ACH entry detail record. The addenda carries supplemental data supporting a payment, such as a remittance advice or beneficiary data. An ACH file can be processed with or without addenda records.

ACH File Batch Control Record:

The Batch Control Record announces the end of the batch. It contains totals for the batch such as number of items, total dollar amounts, and a summation of account numbers. Each batch must have a control record before another batch can commence.

ACH File Control Record:

The File Control Record is located at the end of the last batch in an ACH file. It is a control record that announces the end of the file. The File Control Record includes a summary of all the batch control records.

TRANSMITTING ACH FILES:

ACH files must be delivered to the Federal Reserve via an electronic submission process. Our financial institutions can utilize any of the following three mechanisms for submitting their ACH files to the Federal Reserve.

Fedline:

FedLine is the Federal Reserve PC-based software application whereby enabling our financial institutions to originate and receive ACH debits, credits, return items, and notifications of change (NOCs). Information can be entered into FedLine via key entry, or information can be downloaded or imported into the Horizon ACH warehouse.

Application Program Interface (API):

An API offers the fastest method of delivery and receipt of ACH files and is recommended for high-volume financial institutions. IFS can either use the Federal Reserve Bank's Bulk-data transmission utility or write our own API using the Federal Reserve's Computer Interface Protocol Specifications (CIPS). A benefit to an API allows for the data encryption of the ACH files while providing global access to all Federal Reserve districts.

EXECUTIVE SUMMARY

Correspondent Processing:

An alternative for our financial institution is to process their ACH files through a correspondent bank or third party who has an established ACH connection with the Federal Reserve.

ORIGINATOR AGREEMENT:

Before financial institutions are permitted to become an Originator, a contractual agreement must be established between the Originator and the ODFI that binds the Originator to ACH Rules. In addition, the agreement will need to define the responsibilities of each party, identify the processing requirements for specific applications, and establish liability and accountability for the processing procedures. In some instances, sections of the agreement may be superseded by applicable federal or state law, such as the Uniform Commercial Code Article 4A and/or the Electronic Funds Transfer Act.

IDENTIFYING RISK:

As with any new product offering, we need to evaluate the risk associated with ACH origination and mitigate these risks to the best extent possible. ACH risk exposure generally stems from participant's failure to provide necessary funds to satisfy settlement. Typically, these related losses arise from bankruptcy. There are five fundamental exposure risks associated with ACH processing, which are illustrated below:

ODFI Credit Risk:

The ODFI is exposed to credit risk between the time it releases the ACH file to the Federal Reserve until the Originator funds its account. Generally, the Originator will fund its account on the day of settlement (1 or 2 business days after origination). Because ACH Rules do not allow ACH credits reversal for the failure of an Originator to fund its account, financial institutions are responsible for payment of these items for up to two days or until they receive funding from the Originator.

The origination of ACH credit items results in debit settlement for the total value of the file. Because needed funds may not be available from the Originator on settlement day, the risk is equal to the total amount of the file. There are two approaches that our financial institutions can use to limit this ACH credit risk. For un-established or weak credit accounts, pre-funding may be used. With this

approach, the Originator pre-pays the full amount of their credit origination file before it is transmitted. Overnight interest can be paid to compensate the Originator or interest can be accrued to offset processing fees. A second, more common approach is to qualify the Originator for a line of credit equal to their maximum credit exposure.

ORIGINATION OF AN ACH CREDIT FILE

DAY 1	DAY 2/3
An ACH credit file is sent from the Originator to the ODFI.	The ODFI's account is charged by the Federal Reserve Bank.
The ODFI processes the file and delivers transactions to the Federal Reserve Bank.	The Originator declares bankruptcy.
ACH credits are delivered to the RDFIs by the Federal Reserve Bank.	The ODFI has an unsecured claim against the Originator for the entire amount of the ACH credit file.

Debit Transaction Risk:

When a financial institution processes ACH debit transactions, the items settle one business day after the day of origination. As a result, banks will make funds available to the Originator for the total value of the file on settlement date. Because items can be returned, the ODFI experiences credit risk from the time it grants the Originator credit for the total value of the file until the time the returns have expired. Like paper checks, ACH items can be returned for several reasons such as insufficient funds, account closed, unauthorized transaction and stop payment.

In general, returns are due back to the ODFI by opening of business on the day following the original settlement date. Consumer ACH debit items returned as unauthorized or revoked authorization must be returned within 60 days. When a financial institution receives a returned ACH debit, they will charge the item back to the Originator's account. If the account is closed, has a negative balance, or is frozen due to bankruptcy, they may suffer a loss for the amount of the returned item.

Operational Risk:

Operational risk is the risk that a transaction will be altered or delayed due to an unintentional error. Examples of operational risk include loss due to clerical error or hardware and software failures. As a result, the timing of ACH processing may be altered. To decrease operational risk, our financial institutions will need to implement comprehensive procedures that reduce their operational risk.

EXECUTIVE SUMMARY

Fraud Risk:

Fraud risk results from a transaction being initiated or altered to misdirect or misappropriate funds. Fraud risk may result from employees or corporate customers attempting to embezzle money, or from an external source gaining unauthorized access. There are several ways to reduce the risk of fraudulent activities being perpetrated. One method is to place specific limits on the dollar amount an Originator is authorized to originate. Another method is to confirm control totals with someone at the Originator other than the person(s) who created and sent the file.

Safety and Soundness regulation outlines that financial institutions can reduce the chances of fraudulent activities by ensuring that no single employee is responsible for the receipt, handling, and transmission of ACH files. Furthermore, all changes made to a file must be authorized by the customer, documented by employees, and approved by management. The implementation of sound risk management practices over computers, communications, and operations areas, as well as the establishment of stringent data security procedures are also ways to mitigate fraud risk.

Systemic Risk:

Systemic risk is best defined as the domino effect. It is the risk that an ACH participant's inability to settle its commitments will cause other participants to be unable to settle their commitments. Unlike credit, operational, and fraud risk, individual financial institutions cannot control their exposure to systemic risk.

MITIGATING RISK:

The following outlines various reports and procedures that should be integrated in your ACH Origination product in order to mitigate risk :

- ACH control log to record selected information of incoming ACH files. The Log provides a daily summary of expected ACH activity.
- ACH transmittal register to be completed by the Originator and submitted with ACH files. The transmittal register summarizes the Originator and ACH information contained in the file and can be used to balance the file once it has been processed.
- Originators reports for ACH settlement amounts and notices of any return items or Notifications of Change.
- A Federal Reserve acknowledgment report. This type of report compares the items and dollar totals transmitted to the Federal Reserve.
- Develop and implement the functionality to reconcile total item counts by category, Originator, and billing period.
- Develop and implement user-defined parameters to place funds holds, whereby reduce customer funds availability, and establish customer monetary thresholds limits, and reports thereof.

ORIGINATION AND RETURN OF AN ACH DEBIT ITEM

