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Norwest Treasury Management

Return Check Processing

New Ways to Handle an Old Problem

Increasing Return Check Processing Efficiency

In today's low margin business environment, companies are looking for new ways to increase efficiency and profitability. One treasury function in which you may have an opportunity for significant improvement is return check processing.

Until recently, treasurers' options for return check processing have been few. You could: 1) utilize an in-house collections area to try to collect on bad checks; 2) use an outside collection agency; and/or 3) have your bank re-deposit bad checks prior to sending them for collection. In these options, your bank played only a minor role by offering special return handling instructions, such as "First Time Re-deposit" and "Deliver to Alternate Address", i.e., the address of your collection agency. Because in-house departments and outside agencies are expensive, some companies have chosen to write-off relatively low dollar bad checks rather than pay the high costs of collection.

Today, bad check write-offs and/or high return collection costs can strain profits and put companies at a competitive disadvantage. What's more, the number of NSF and fraudulent checks is growing. *What treasurers need are increased collection rates; better, faster information on returns; and a cost effective alternative for collecting low dollar checks that will help reduce overall check write-offs.* Fortunately, there are new methods of return check processing that can meet those needs.

The purpose of this paper is to explore return check processing and the family of products that are now available.

New Rule Clears the Way for Electronic Return Check Collection

Re-presenting paper checks through normal check clearing channels is slow, cumbersome, expensive- and the collection rates are extremely unpredictable. A NACHA rule change approved in March of 1998 clears the way for companies to collect return checks electronically.

The name for this process is RCK, which stands for Re-presented Check. RCK is the electronic re-presentation of return checks through the Automated Clearing House Network. Rather than re-presenting a physical check for payment, an ACH debit entry for the amount of the check is made to the check writer's account.

Under NACHA's Operating Rules for the ACH Network, RCK is the new Standard Entry Class Code for re-presenting a previously returned check as an electronic debit transaction. The RCK rule becomes effective September 15, 2000. An interim rule that went into effect September 17, 1998, allows ACH participants to collect checks through ACH prior to that date by using the existing Preauthorized Payment and Deposit (PPD) Standard Entry Class Code to initiate the transactions.

The final RCK rule and the interim PPD rule differ technically in the ACH format and return reason codes used in the electronic transactions. The key functional difference is that, under the PPD interim rule, serial numbers of checks collected electronically may or may not be printed on consumers' bank statements. The final RCK rule requires that consumers' bank statements include the following information: check serial number, payee's name, dollar amount, and the description REDEPCHECK. The ACH debit must be for the face value of the check only-no collection fees can be charged.

ACH Advantages

Many of the advantages that ACH brings to traditional payment and collection systems also apply to return check processing-including speed and cost efficiency. Speed is important in return check

processing because the faster the re-presentation, the faster the collections, and the better your cash flow. Also, according to theory, fresh checks are easier to collect than stale ones. Presenting a physical check twice and settling the transaction, if it clears, normally takes from 14 to 22 days. When re-presentation is electronic, the time involved is cut to as few as eight days resulting in better collection rates. ACH cost efficiency means you can justify submitting lower dollar checks for return collections. The ACH network coupled with the RCK rule offers additional advantages in return check processing.

More Presentments

Checks in their physical form may be presented for payment once and re-presented once-for a total of two presentments. Up to 50% of return checks are collected on first re-presentation. That leaves 50% or more of return checks that are not collected. Using RCK gives you an extra chance to collect these checks. And, as the saying goes, "Third time's a charm." Once the paper checks are returned through the check clearing network, they may be re-presented for payment twice more-for a total of three presentments. The re-presentments may both be electronic or one may be paper, the other electronic. It's your choice. Tests show that, on average, the third presentment collects an additional 25% to 50% of NSF checks.

First Claim

Electronic transactions usually get first claim to any cash in the account. The reason is that banks routinely post ACH transactions to consumers' accounts before they post checks. Even if the available funds are insufficient to cover all items posted, the likelihood that you'll collect is higher if you re-present an ACH entry than a paper check.

Control of Timing

You can specify timing of ACH re-presentments. For example, re-presentments can be submitted the day after payday-on the 1st or 15th of the month or on Friday-when businesses expect more funds to be in check writers' accounts.

Fraud Reduction

The fact that ACH re-presentments are faster than paper means that you can identify fraudulent check writers more quickly, enter their information into the negative database, and stop them from passing more bad checks.

Faster Notification

Most ACH returns, particularly returns for insufficient and uncollected funds, must be available to the merchant's bank within two days of the original settlement date. Using RCK to re-present checks means you are notified of return items faster and can react more quickly to represent checks a third time through the ACH or to collect by other means.

Consumers benefit too

Today, taking a consumer's name off the file of bad check writers is work. Information from each check must be re-keyed once the funds are collected. Use of ACH check re-presentation will result in quicker removal of negative information from check verification databases. Once funds are collected, files and databases can be updated automatically from the ACH collection files. This means consumer checks can be accepted again sooner.

RCK Isn't For All Checks

To be re-presented through the ACH Network, return checks must meet all of the following criteria:

- Face value under \$2,500
- Two-party consumer checks only-no corporate or third party checks
- Returned for insufficient or uncollected funds only -not for stop payments or closed accounts
- Less than 180 days old-no stale-dated checks

These qualifications make electronic re-presentation particularly appropriate for low-dollar checks written for purchases or bill payments-checks that may have previously been taken as write-offs because of their high cost of collection.

You Must Notify Your Customers

ACH entries normally require pre-authorization by the person whose account will be debited or credited. Electronic check re-presentation requires only pre-notification of customers. Notification by a merchant can take the form of simple point of sale signs at cash registers that read something like this: "Checks returned for NSF or uncollected funds may be collected electronically."

By writing checks, customers agree to accept the merchant's collection terms. Billers can notify their customers through a similar notice on their monthly billing statements or on statement stuffers. Physical checks or check copies must be made available to customers on request. The NACHA rule requires that, for the first 90 days, the original check be provided within 10 business days of a customer's request. For seven years, a copy of the check must be provided within 10 days of request.

How Will You Handle Return Check Processing?

In keeping with today's streamlined treasury departments, return check processing is becoming more efficient, more technology driven, and more cost effective. New products available enable you to not only increase your return check collection rates and reduce your collection costs, but to track and analyze return check problems with more detailed information and reporting than has previously been available. If your focus is on further streamlining your staff, you can now outsource the entire return process. The product that's right for you will depend upon your type of company, return check volumes, reporting needs, and internal systems capabilities.

RCK Software

PC software packages now available from banks and software vendors enable companies to create their own ACH re-deposit files. Investment in the software designed for ACH transactions may make sense, and creating the files is as easy as entering information from the return checks. This option for RCK is expected to be popular with retailers and many other types of companies. Companies using RCK software are responsible for warehousing the original checks and check copies to meet customers' requests for them as required by ACH rules.

Direct Origination

With direct origination, companies create their own ACH origination files and transmit them directly to their ACH bank for processing. The information captured for return check re-presentation can be used to bill customers for return check processing costs. The barrier to direct origination is that software is not yet readily available. Companies must have the ability to develop custom applications that will interface with other systems and databases that are already in use. The need for development capabilities may limit current candidates for direct origination to large companies such as credit card issuers, check guarantee services, collection agencies, and utilities.

The Smith's Experience

Smith's Food and Drug Centers, Inc., in conjunction with the NACHA Rules Work Group, began a pilot test of electronic check re-presentation in early 1997. Smith's, a corporation with \$3 billion in annual sales, gets approximately 40,000 return checks per month valued at \$3 million. Of those checks, 85% are returned for insufficient funds. For the first 60 days after a check is returned, Smith's handles collections through a series of letters. Their goal is to collect not only the face value of the check, but also the \$35 return check charge, which helps to defray the operating costs of the company's bad check department. Smith's has found that, if a customer is going to reply to the letters, the reply will be made within 60 days. After 60 days, Smith's re-presents the checks through the ACH for collection of their face value only. Every Thursday, they send a disk with the latest return check images to a service provider. The provider enters information from the MICR line of the check images into an application to create ACH PPD debit transactions. A file of these transactions is then sent to a bank for processing through the ACH. Smith's specifies that the transactions be posted to customers' accounts on Monday evening, betting that's when the most money will be in the accounts. The pilot program has been in place for more than a year now with significant results. Of the checks re-presented through the ACH, 40% are being cleared. Smith's bad check losses have decreased by 29%. Smith's estimates that they are saving 30% of their collection

agency costs. Total savings in 1997 were \$450,000 over and above the costs associated with electronic check re-presentment. And, out of 40,000 ACH debit transactions, fewer than 50 of Smith's customers complained.

RCK Outsourcing

The simplest way to implement RCK is to have the bank that has your depository account do it for you. New return item processing special instructions are now or soon will be available at most large, ACH member banks. "Process Returns RCK," and similar instructions, will automatically route your return checks to the bank's RCK processing center. There they will be converted into ACH transactions, and the files will be transmitted to the bank's ACH system. Most banks also will allow you to choose whether the first re-presentment will be paper or electronic (second re-presentments are always electronic) and to control the timing of electronic returns with special instructions such as "Re-Present 1st of Month" or "Re-Present Friday."

Centralized Returns

Regional and national retailers and other companies using multiple banks and deposit locations can get consistent return check processing and handling by consolidating all of their return checks with a single bank or service provider. If you choose this route, your locations will deposit to multiple bank locations, as usual. The consolidation service kicks in only when checks don't clear the first time. Checks that are returned for any reason are routed, via a special endorsement on the checks, to a central bank or service provider for return processing. Once all your returns are consolidated, you can choose to re-present these items through direct origination using in-house software, via paper, or send them through your collection process.

Having a single, centralized provider for all your returns means you get standardized processing, consolidated statements, and one fee structure. Consolidated account statements simplify the treasury management function. Enhanced reporting facilitates early identification of patterns of fraud and locations where fraud or check kiting is an issue. With high volumes going through one provider, you may also benefit from better pricing.

Centralized Returns with RCK

Companies have been taking advantage of centralized returns with paper processing for some time. Now this outsource option is available with electronic re-presentment to decrease your collection times and increase your collection rates. Outsourcing the collection process completely allows you to focus internal resources on core company functions while letting the experts do the work for you.

Centralized returns with RCK offer additional benefits over paper. Faster, electronic processing means faster cash availability. You can control the timing of re-presentment to increase the level of collection. Collection agency costs are reduced because those checks that clear on second re-presentment never go to collection agencies. Fraud is reduced when companies are able to identify occurrences quickly, get the information into a negative database, and halt the acceptance of more fraudulent checks.

Put New Return Check Processing Options to Work for Your Company

Even before the interim PPD rule went into effect, more than a million return check entries a month were going through the ACH. Most of these entries were part of RCK or PPD pilot programs. Some were companies jumping the gun to get a head start on what is clearly an easier, faster, and less expensive way to collect return checks. Now that return checks can be officially re-presented electronically, ACH re-presentment volume is expected to soar.

Norwest Bank Vice President Keith Theisen, who led the NACHA Rules Work Group that developed the RCK rule, is on record as saying, "The collection of return checks through the ACH Network can bring substantial cost and time savings to businesses, consumers, and financial institutions." Now is the time to talk to your bank or service provider about updating your return check processing system. As the second-largest originator of ACH transactions in the U.S., Norwest is ready to help commercial customers take full advantage of RCK.