

Cash management tools from banks

Q 5-05. What are some key banking tools for a cash management program?

Banks have developed various products and services to improve cash management. These products support transaction processing by offering electronic funds transfer, account management, broadly deployable tools using card technology, or other services.

Q 5-05.01. What is a zero balance account?

Zero Balance Accounts (ZBAs) are linked to concentration accounts. At the end of each day, any positive or negative balances are netted leaving a balance of zero in the service account. Because a ZBA can accept deposits or disbursements, it can be used in receipt and payment operations. Their typical use is for payroll or benefits.

Q 5-05.02. What are the advantages of ACH?

As discussed above, an automated clearinghouse is a batch-processed electronic payment system. An ACH system generally allows both the issuance of credits to other accounts and debits. As a batch system, the entire ACH network settles all accounts in the banking system at one point in time during the day. The most convenient time to do so is after the close of business for settlement of the transactions the next day. This means that an ACH transaction is not a same day credit; funds from an ACH transaction will be available at the opening of business the next business day with final posting to accounts at the close of business.

The Electronic Data Interchange transaction formats include payment by ACH among their options. This allows the development of an electronic business transaction system.

An ACH is generally an inexpensive payment mechanism that makes it well designed for a high volume of low-value payments. It offers the advantage that payments can be scheduled up to two weeks in advance. The ACH ability to send debits or credits makes it also well suited for cash concentration systems in which funds can be moved overnight between layers in a pyramid of bank accounts.

Q 5-05.03. How can the risk of errors in ACH transactions be reduced?

A risk with automated systems such as the ACH is that incorrect information can cause payments to be delayed or misdirected when they are not rejected outright. It is important that the bank routing and bank account information for a remittance be correct if the payment is to be made timely. This is a particular risk in situations where payees who are not knowledgeable of banking systems enroll

themselves to receive payments and enter their own bank information.

The validity of bank routing information and the format of the bank account number should be tested in advance of a value transaction. A pre-notification (or pre-note) is a zero-value transaction sent through the ACH by the remitter to the payee's bank account.

Care is needed in understanding what is meant, however, validity. A pre-note does not verify that the bank account number belongs to the payee. In the United States, the RDFI is required only to establish that the routing number belongs to them and the account number appears to be valid. The actual account number may belong to an account which is not currently open or which belongs to someone else.

Q 5-05.04. What bank products help with check payment problems?

Electronic Check Re-Presentation (RCK) assists recoveries from returned checks, by re-presenting them for payment electronically with greater speed and higher priority than traditional paper re-deposit allows.

When paper checks are returned by the payer's bank due to insufficient funds in the payer's account, they can be turned over to a servicing bank for electronic processing. That bank will capture the routing and transit and bank account information from the returned check, and resubmit the item electronically through the ACH network. The advantage of this service is that electronic items are easier to process, are re-presented for payment more quickly than paper items, and generally are given priority in the re-presentation process over paper checks.

Q 5-05.05. What bank products help with ACH fraud protection?

Automated clearinghouse systems can transmit either debits or credits and no evidence of prior authorization is required of the sender. With final settlement of transactions at the close of business day, there is a limited time for identifying unauthorized debits issued against an entity's accounts. Many banks offer two services to help an organization avoid the risk of potentially fraudulent, inaccurate, or untracked automated clearinghouse transactions. Both restrict potentially fraudulent ACH transactions from posting to an account.

ACH Debit Blocking will protect against paying unauthorized ACH debit transactions. In its basic form, it blocks all ACH debit entries and returns the items to the originator. Blocks that are more sophisticated enable the user to specify which entities are authorized to post ACH debits to one's accounts and will automatically block those that are not authorized.

ACH Debit Filtering will allow debits to be issued against an entity's accounts only

if the debits meet certain pre-specified criteria. If an incoming ACH debit does not match to the authorized list, the ACH transaction will automatically be returned to the originator.

The pre-specified filters that may be applied to incoming debits might include:

- Company identification
- Dollar amount or range
- Transaction types
- Single Payment Authorization
- Recurring Payment Authorization
- Authorization Expiration Date

Q 5-05.06. What are the uses of a real time gross settlement system?

As discussed above, in real time gross settlement systems (RTGS) funds or securities are transferred between banks on a "real time" and "gross" basis. Settlement in "real time" means payment transaction is not subjected to any waiting period; transactions are settled as soon as they are processed. "Gross settlement" means the transaction is settled on one-to-one basis without bunching or netting with any other transaction. Once processed, payments in an RTGS are final and irrevocable.

The RTGS system is suited for low-volume, high-value transactions. It lowers settlement risk, besides giving an accurate picture of an institution's account at any point of time. The implementation of RTGS systems by central banks throughout the world is driven by the goal to minimize risk in high-value electronic payment settlement systems.

Q 5-05.07. What tools can assist in check payment management?

A check system protection corresponds to ACH debit filtering. This is *positive pay*. Positive pay is an anti-fraud service offered by most commercial banks. It protects check issuers against altered checks and counterfeit check fraud.

When a company issues checks for any purpose (and particularly in quantity) it sends a copy of its issue file, a list of the checks that were issued (check number, payee, and dollar amount), to the bank where its checks clear. When the checks are presented to the bank for payment, the bank matches each check presented against the issue file. If the presented check's number, payee, and amount match the previously submitted list, the check is sent through for payment. If items do not match, the check is not cleared. Thus, any check considered potentially fraudulent is sent back to the issuer for examination.

Although it is effective at catching bad checks, the positive-pay system costs more than other systems. For example, the reverse positive-pay system requires check issuers to self-monitor; the issuer must then alert the bank when it declines a check. This method, while cheaper than positive pay, is not as reliable.

Q 5-05.08. What bank products support check receipt systems?

Three services from banks can support receipts management when the remittances are paid by check. These are lockbox services, reporting of deposits by location, and remote deposit.

A lockbox system is a means of receiving remittances by mail at a post office address. Generally, remitters receive bills with instructions directing payment to a post office address. A bank is given responsibility for sweeping the mail regularly from this site, transferring it to the bank's work facilities, opening the mail, and processing the payments for daily credit to the recipient's account. When the recipient expects a high volume of payments, a payment coupon enclosed by each remitter may be read by optical character recognition equipment to speed reconciliation of each customer's accounts and to concentrate funds.

When an entity has several deposit points, banks can offer reporting of deposits by location. This leads to a cash concentration system while taking advantage of multiple deposit sites. Often, a unique serial number on each location's deposit slips enables the bank to identify and report deposit activity by location. The advantages of this system include:

- Reduced bank fees and in-house expenses by eliminating multiple deposit accounts and deposit transfers.
- Detailed, summary deposit reports by location that can be produced daily, weekly or monthly.
- Identification of returned deposited items and deposit corrections by location to speed reconciliation.
- Concentrated deposits in a single account covers disbursement needs and take advantage of investment opportunities.

Remote deposits were discussed in the topic of check truncation and conversion. It requires equipment to read the MICR information from a check or to scan the check to capture its image at some location outside of the depositing bank. One of the more convenient sites is at the point of purchase or of payment, such as at a tax payment window of an agency. The equipment provides "on-site" conversion of checks to electronic funds transfer or images for deposit.

Q 5-05.09. What are the uses of credit cards?

Credit cards are useful tools for small purchases or receipts because of their near

universal acceptance and ownership. Purchase cards are discussed below.

Credit cards may be used to accept payments. Because card transactions are priced by banks as a discount of the value of the transaction, they should be used for lower value receipts. Because lockbox or ACH debit systems are cheaper than cards when used for frequent or recurring customers, cards should be used for payments from occasional or intermittent payers.

Q 5-05.10. What are the advantages of purchase cards?

Using a purchase card simplifies the purchasing and payment process and thus achieves a lower overall transaction processing cost per purchase. It reduces the internal flow of paperwork, such as purchase orders, and reduces the number of payments needed. Instead of generating a payment, such as a check, for each purchase, a single payment is made to the issuing bank for all purchases made within the statement period. The documentation from the card-issuing bank provides more detailed information about the card (or location) making the purchase, the vendor used, and the cost.

Multiple cards can be deployed, one at each office location. This decentralizes the purchasing function and reduces another internal flow of paperwork as purchase orders are no longer sent to a central site for approval and execution.

Issuing banks can tailor purchase cards to better control their use. Each card can have a separate purchase limit and cards can be limited to an approved set of vendors. This is particularly useful to control for employees who may attempt to use the card for personal use.

Q 5-05.11. How do credit cards transfer value?

A credit card is a plastic certificate issued to a party by a bank (issuing bank) that acknowledges the issuing bank's readiness to advance funds to merchants to cover purchases or obligations made by the cardholder. The issuing bank assumes responsibility for the task of eventually recovering from the cardholder the funds advanced to the merchant. The merchant can accept payment by credit card because he has a relationship with a bank (acquiring bank.) The acquiring bank credits the account of the merchant for the amount of the transaction (less a merchant fee that is usually between 2% and 6% of the value of the transaction) and assumes the task of recovering funds from the issuing bank.

The acquiring bank receives the draft, or an electronic equivalent of such, drawn by the cardholder from the merchant. The acquiring bank is in the same situation as the presenting bank in the discussion of checks: it must present the draft to the issuing bank to recover the funds it has credited to the merchant's account. The draft may be an "on us" transaction if the acquiring bank is also the cardholder's

issuing bank. Otherwise, the acquiring bank uses a special clearinghouse to present the draft. This clearinghouse is an association with a name such as VISA or MasterCard. Each credit card has a unique identifying number that functions like the information printed on the MICR line of the check: it identifies the issuing bank and the account number that have created the draft.

If the use of the card generates a debit against a cash account of the cardholder rather than creating an account receivable from the cardholder at the issuing bank, the plastic card is called a debit card. Because a debit card transaction immediately transfers funds from the cardholders account rather than extending credit that has a higher risk, the fees for debit card transactions can be much less than the merchant fees.

Q 5-05.12. What is SWIFT?

The Society for Worldwide Interbank Financial Telecommunications (SWIFT) is a cooperative society of depository institutions and some central banks formed in 1973. It is a secure, inexpensive international message system. It is NOT a funds transfer system. It functions by sending standardized format administrative messages for:

- Funds transfers for customers
- Funds transfers for the bank's account
- Confirmation of foreign exchange transactions
- Confirmations and advices concerning loans and deposits
- Collection advices and payment acknowledgments
- Letters of credit
- Balance reports
- Advices and confirmations of securities transactions.

SWIFT can be used only between member banks for these particular messages. The actual settlement of funds goes through a correspondent bank operating on the instructions from the member bank that has received the SWIFT message.

Section C: Banking services procurement.