



AUTOMATED CLEARING HOUSE (ACH) TRANSFERS: HOW DO THEY WORK?

By Phillip Silitschanu



WHAT ARE ACH TRANSFERS?

There are numerous ways to transfer funds between personal and business bank accounts, and each has distinct advantages and disadvantages. One of the most widely used transfer types is Automated Clearing House transfers or ACH transfers. The ACH system is a nationwide network, through which depository institutions (such as banks) send each other credit and debit transfers.

Typical examples of ACH transfer credits are:

- Direct Deposit of Employees' Salaries
- Social Security Benefit Payments
- Tax Refunds.

Typical examples of ACH transfer debits are:

- Mortgage Payments
- Utility Bill Payments
- B2B Payments.²

Because ACH transfers are entered and transmitted electronically, instead of through paper checks, they are faster and safer.

ACH TRANSFERS USAGE

ACH transfers move over US\$40 trillion per year, through nearly 23 billion financial transactions. In fact, 90 percent of the total value of electronic payments in the United States is conducted through ACH transfers.¹

ACH Transfers : How Do they Work?

ACH Transfers are based on a batch processing system, instead of a real time processing system. This means that banks and other financial institutions receive and store payment senders' instructions throughout the day, and are then transmitted electronically as a batch of information to other financial institutions. An ACH Transfer involves the following steps:

1. A person, business, or other entity (such as a government agency) initiates a direct deposit or direct payment transaction by ACH network
2. ACH transfer information is transmitted by the bank (referred to as the Originating Depository Financial Institution) and is received by one of the two centralized clearing facilities: The Federal Reserve or The Clearing House.
3. The ACH transfer data is then sorted, and made available by the clearing facility to the banks which are indicated as being the recipients of the ACH transfers. These are referred to as the Receiving Depository Financial Institutions.
4. The receiving institutions (i.e., banks) then debit or credit the accounts of the persons or businesses which are specified in each ACH transfer.

Once this information is received, each ACH transfer that is a credit settles within one to two days, while ACH transfers which are debits settle in only one business day.³ Thus, the transfer of information happens quickly, in the same day. It is the actual settlement of funds into accounts which can take several days.

ACH Network 2016: Quick Stats¹

- > **Growth in Volume:**
More than 25 billion electronic payments (+5% YoY)
- > **Total value of transactions:**
More than \$43 trillion (+5% YoY)
- > **Volume of B2B transaction:**
+5.2% YoY
- > **Total Number of Direct Deposits:**
6.1 billion Direct Deposits (+5% YoY)

Advantages of ACH Payments?

ACH transfers are a useful tool for persons and businesses, but it is important to understand that transfers are not instantaneous. ACH transfers can take several days to settle. While for some transactions this delay is acceptable, in other situations funds are required to be transferred nearly instantly. In these situations, other types of fund transfers are preferable, such as wire transfers.

Ease:

For businesses, an advantage of using ACH transfers is the ease through which businesses can establish automated accounts payable and accounts receivable payments, to help develop a more predictable cash flow while also reducing operational overhead due to manual processing of regular transfers and payments.

Low Cost:

Most banks don't charge any fees for ACH transfers, and the ones that do generally only charge about US\$3.00.⁴ A few also charge slightly higher fees for "assisted transfers," when a bank employee helps the sender to set up the ACH transfer, instead of simply setting it up online. ACH transfers are also usually less expensive than accepting a credit card payment, although it is much less convenient, and much slower as well.

Secure Transfers:

Through ACH transfers, there is a certainty that the funds received will not be reversed, or have chargebacks. Unlike credit card payments, which can be disputed, reversed, charged back, or put on hold, ACH transfers can only be reversed for three specific reasons:

- if the ACH transfer was not for the exact amount authorized
- it was processed (transferred) earlier than the authorization date
- if it was not authorized at all

With ACH transfers, if there is a failure in the transfer process, such as the funds not being available, the recipient is notified immediately.⁵ With other funds transfer methods, businesses do not have the certainty that the payments they have received are truly settled and undisputed. This can cause cash flow planning issues, or worse, a business may use the received funds to pay suppliers, only to have those funds withdrawn from their account if there is a dispute down the road.

ACH TRANSFER VS WIRE TRANSFER

ACH transfer is cheaper than a wire transfer, which typically costs about \$25 to send and \$10 to receive. Wire fees are higher for international transfers, often more than \$40. There's a reason for the higher fees: Wire transfers take hours, while ACH transfers take days.⁴

Conclusion

ACH transfers are a convenient and inexpensive way to send and receive funds and payments. They are very reliable and very low cost, but they can be slower than other transfer options. Businesses can weigh the pros and cons of each type of transfer option, to determine if ACH transfers, wire transfers, checks or other options are best suited to their particular needs.



About the Author

Phillip Silitschanu is the founder of Lightship Strategies Consulting LLC, and CustomWhitePapers.com. Phillip has nearly 20 years as a thought leader and strategy consultant in global capital markets and financial services, and has authored numerous market analysis reports, as well as co-authoring Multi-Manager Funds: Long Only Strategies. He has also been quoted in the US Financial Times, The Wall Street Journal, Barron's, BusinessWeek, CNBC, and numerous other publications. Phillip holds a B.S. in finance from Boston University, a J.D. in law from Stetson University College of Law, and an M.B.A. from Babson College.

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