ACH Network Risk and Enforcement Topics

This Rule will improve the overall quality of the ACH Network by reducing the incidence of returned Entries and the associated costs, both financial and reputational, that such returned Entries impose on the ACH Network and its participants. The approach to reducing risk with this Rule is multi-fold, as described by the various topics below. These changes are also expected to increase customer satisfaction with the ACH Network by reducing the volume of transactions subject to customer disputes.

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Topic 1- Reducing the Unauthorized Return Rate Threshold

The Rule will reduce the current return rate threshold for unauthorized debit Entries (Return Reason Codes R05, R07, R10, R29, and R51) from 1.0 percent to 0.5 percent. This revised threshold is still more than 16 times higher than the average Network return rate of 0.03 percent for unauthorized debit Entries for calendar year 2013. NACHA believes that unauthorized debit returns at 0.5 percent would still indicate problematic origination practices, and therefore would be a useful tool to enable NACHA to focus on outliers of poor quality origination activity.

The Rule will not change any of the existing risk investigation or enforcement processes related to the unauthorized return rate threshold. An ODFI that has an Originator or Third-Party Sender that breaches the lower threshold would be subject to the same obligations and potential enforcement as currently set forth in the *Rules* for the existing return rate threshold for unauthorized debits.

Topic 2- Establishing Inquiry Process For Administrative and Overall Return Rate Levels

The Rule will establish an inquiry process that will provide NACHA with a preliminary evaluation point to research the facts behind an Originator's ACH activity. Preliminary research, as part of the inquiry process, begins when any Originator exceeds the established administrative return rate or overall return rate level. The review process involves eight steps, and includes an opportunity for NACHA and an industry review panel to

review an Originator's ACH activity prior to any decision to require a reduction in a return rate. The inquiry process does not automatically trigger a Rules enforcement activity.

The established administrative return rate level of 3.0 percent would apply to debit entries returned due to administrative or account data errors (Return Reason Codes R02, R03 and R04). This level is more than 9 times higher than the industry average ACH Network debit return rate for account data errors of 0.33 percent in 2013. This breakpoint would be a useful tool to enable NACHA to look more closely at an Originator's or Third-Party Sender's origination practices to determine whether poor origination practices are leading to high return rates that should be reduced. A return rate level above 3.0 percent will **not** automatically be considered a *Rules* violation or result in a *Rules* enforcement proceeding. Rather, a return rate above the level will be considered a starting point for a review of the Originator's or Third-Party Sender's origination activity to determine if a reduction is warranted.

The established overall return rate level of 15.0 percent would apply to all debit entries (excluding RCK entries) that are returned for any reason. This level is approximately 10.5 times higher than the overall industry return rate average of 1.42 percent in 2013. While some level of returns, including for funding-related issues such as insufficient funds, may be unavoidable, excessive total returns also can be indicative of problematic origination practices.

As with the administrative return rate level, a level of 15 percent would be a useful tool to enable NACHA to look more closely at an Originator's or Third-Party Sender's origination practices to determine whether poor origination practices are leading to high return rates that should be reduced. The Rule sets the return rate level at a point that is not so high that it fails to identify unnecessarily high-risk Origination practices, nor so low that it identifies many businesses in industries that experience higher than normal return rates as a matter of course but that otherwise would not be considered problematic.

Topic 3 - Reinitiation of Entries

Reinitiation is the method permitted in the *Rules* by which a Returned Entry may be resubmitted.

In July 2013, NACHA issued ACH Operations Bulletin #3-2013 titled "Reinitiation of Returned Debit Entries" in an attempt to clarify that various types of Entries used by such Originators are indeed "reinitiated" Entries and therefore already are restricted, and in some cases prohibited, by the existing Reinitiation Rule. Nonetheless, in order to leave no ambiguity in this regard, the Rule formally incorporates into the *Rules* several clarifying changes to the Reinitiation Rule consistent with the principles set forth in ACH Operations Bulletin #3-2013.

Most fundamentally, Subsection 2.12.4 of the *Rules* implicitly prohibits the reinitiation of Entries outside of the express limited circumstances under which they are permitted under the *Rules*. The Rule makes this prohibition explicit.

Consistent with ACH Operations Bulletin #3-2013 "Reinitiation of Returned Debit Entries," the Rule requires

a reinitiated Entry to contain identical content in the following fields: Company Name, Company ID, and Amount. Further, the rule permits modification to other fields only to the extent necessary to correct an error or facilitate processing of an Entry. This change will allow reinitiations to correct administrative errors, but prohibit reinitiation of Entries that may be attempts to evade the limitation on the reinitiation of returned Entries by varying the content of the Entry.

Finally, the Rule addresses two technical issues associated with the Reinitiation Rule. First, the ODFI would be required to include the description "RETRY PYMT" in the Company Entry Description field to identify Entries that are permissible resubmissions of Returned Entries under the Reinitiation Rule. Use of this description in the field would notify the Receiver that the Entry relates to a previously Returned Entry, and will facilitate research and dispute resolution for RDFIs. Second, there is not currently a separate Return code for an RDFI to indicate when an Entry is being returned for a violation of the Reinitiation Rule. The Rule will allow such returns to use Return Code R10 (currently used for Extended Returns) to include a Return for a violation of the Reinitiation Rule, since most violations of the Reinitiation Rule are likely to be identified via a customer complaint after the expiration of the "two-day" return timeframe (i.e., an extended return timeframe would be necessary). In order to use R10 and the extended return timeframe, the RDFI will need to obtain a Written Statement of Unauthorized Debit.

Topic 1- Reducing the Unauthorized Return Rate Threshold

The new rule will make the following changes to the Rules regarding the Unauthorized Return Rate Threshold

- Article Two, Subsection 2.17.2.1 (ODFI Return Rate Reporting Regarding an Originator's or Third-Party Sender's Unauthorized Entry Return Rate): creates new subsection heading and modifies text that is specific to the unauthorized Entry return rate
- Article Two, Subsection 2.17.2.2 (Additional ODFI Action and Reporting When the Unauthorized Entry Return Rate Threshold is Exceeded): creates new subsection heading and modifies text that is specific to the unauthorized Entry return rate
- Article Two, Subsection 2.17.2.3 (ODFI Reduction of Unauthorized Entry Return Rate): creates new subsection heading and modifies text that is specific to the unauthorized Entry return rate
- Article Eight, Section 8.105: creates a new definition for "Unauthorized Entry Return Rate Threshold"

Topic 2- Establishing Inquiry Process For Administrative and Overall Return Rate Levels

The new rule will make the following changes to the *Rules* regarding the Inquiry Process for Administrative and Overall Return Rate Levels

- Article Two, Subsection 2.17.2.4 (ODFI Return Rate Reporting Regarding an Originator's or Third-Party Sender's Administrative Return Rate or Overall Return Rate): establishes new subsection on ODFI response to a NACHA written request for information

- Article Two, Subsection 2.17.2.5 (Additional ODFI Action and Reduction of Administrative Return Rate and/or the Overall Return): establishes new subsection on ODFI response to a written directive to lower a return rate
- Article Two, Subsection 2.17.2.6 (ODFI Reduction of Administrative or Overall Return Rate): establishes new subsection with timeframes within which and ODFI must lower return rates
- Article Eight, Section 8.89: creates a new definition for "Return Rate Level"
- Appendix Ten, Subpart 10.2.1 (National Association Request for Information): broadens text to include reference to Return Rate Levels and National Association use of information from RDFIs
- Appendix Ten, Subpart 10.2.2.1 (National Association May Initiate an Inquiry Regarding an Administrative Return Rate or an Overall Return Rate): creates new subpart to discuss inquiry procedure
- Appendix Ten, Subpart 10.4.3 (Submission Requirements for Rules Enforcement Proceedings Initiated by the National Association): modifies text to include address submission requirements under new procedure

Topic 3 - Reinitiation of Entries

The Reinitiation Rule on will make the following changes to the Rules:

- Article Two, Subsection 2.12.4.1 (General Rule for Reinitiated Entries): creates a new subsection to specifically define a Reinitiated Entry
- Article Two, Subsection 2.12.4.2 (Formatting Requirements for Reinitiated Entries): creates a new subsection to address the specific formatting of the Company Description Field for Reinitiated Entries
- Article Two, Subsection 2.12.4.3 (Improper Reinitiation Practices): creates a new subsection to address Improperly Reinitiated Entries
- Article Three, Subsection 3.12.4 (Improperly Reinitiated Debit Entries): adds new subsection regarding Reinitiated Entries
- Article Three, Subsection 3.12.5 (RDFI Must Accept Written Statement of Unauthorized Debit): adds a new item (e) for Reinitiated Entries
- Article Eight, Subsection 8.78 ("Reinitiated Entry" or "Reinitiation" or "Reinitiate"): establishes definitions for terms related to Reinitiated Entries
- Appendix One, Part 1.2 (Data Specifications for ACH Records): adds "RETRY PYMT" to the list of field contents for the Company Entry Description
- Appendix Three, Subpart 3.2.2 (Glossary of Data Elements): adds "RETRY PYMT" to the list of field contents for the Company Entry Description
- Appendix Four, Part 4.2 (Table of Return Reason Codes): modifies Return Reason Code R10 to include Improperly Reinitiated Entries
- Appendix Ten, Subpart 10.4.6.2 (Responsibilities of Enforcement Panel): includes a new ACH Rules Enforcement Panel responsibility related to Reinitiated Entries

Topic 1- Reducing the Unauthorized Return Rate Threshold

*All Participants***:** NACHA expects all ACH Network participants to benefit from the reduction of the return rate threshold for unauthorized debit entries.

ODFIs: ODFIs should already have monitoring in place regarding their Originators and Third-Party Senders unauthorized debit return rates.

Originators and Third Party Senders: Originators and Third-Party Senders with unauthorized debit return rates above the new threshold may be required by their ODFIs, and, in the case of some Originators, their Third-Party Senders, to take action to reduce their return rate, and will incur costs in doing so.

Topic 2- Establishing Inquiry Process For Administrative and Overall Return Rate Levels

*All Participants***:** NACHA expects all ACH Network participants to benefit from the establishment of an inquiry process to research the facts behind an Originator's ACH activity should an Originator exceed an established administrative return or overall return rate level. The amendment is expected to encourage ODFIs to focus on reducing the number of Returns and thereby reducing the number of transactions entering the ACH Network that result in exceptions and returns. Finally, all ACH Network participants should benefit from the ability of NACHA and the ACH Operators to collectively monitor returns at the Network level.

ODFIs: ODFIs should already have monitoring in place regarding their Originators and Third-Party Senders return rate levels. Some ODFIs may incur costs to develop and implement policies and procedures related to the new return rate levels. Finally, some ODFIs may incur costs associated with replying to information requests from NACHA.

Originators and Third Party Senders: Originators and Third-Party Senders with return rates above the new levels may be required by their ODFIs, and, in the case of some Originators, their Third-Party Senders, to take action to reduce their return rates, and will incur costs in doing so.

RDFIs: RDFIs will benefit from a reduction in the number of transactions that cause exceptions and returns, with an attendant reduction in the cost of processing such returns, the cost of Regulation E dispute resolution compliance, and the cost of responding to customer complaints (call centers, branches, and online customer service). Further, RDFIs are often unfairly blamed for these transactions, so a reduction in these transactions also would reduce the reputational harm RDFIs suffer.

Topic 3 - Reinitiation of Entries

All Participants: NACHA expects all ACH Network participants to benefit from the reduction of the return rates associated with reinitiated Entries. These changes are expected to provide clarity to ODFIs with respect to the existing limitations and qualifications on reinitiations, thereby reducing the number of returned reinitiated Entries.

ODFIs: Although the rules are consistent with NACHA's interpretation of the existing reinitiation Rule, some ODFIs, particularly those with practices that do not comply with the limitation on and requirements for

reinitiating returned Entries, are likely to incur additional costs associated with the development and implementation of better policies and procedures to ensure compliance with the *Rules*. ODFIs will incur some cost in modifying systems to include the "RETRY PYMT" description in Reinitiated Entries.

Originators and Third Party Senders: Originators and Third-Party Senders whose practices do not comply with the limitations on and requirements for reinitiating returned Entries are likely to incur additional costs associated with the development and implementation of better policies and procedures to ensure compliance with the Rules. Originators will incur some cost in modifying systems to include the "RETRY PYMT" description in Reinitiated Entries.

RDFIs: RDFIs will benefit from a reduction in the number of improperly reinitiated Entries and from clarification of the means by which such Entries may be returned. RDFIs' consumer Receivers will be provided with the Entry description that the Entry is a "Retry" at collecting the payment. RDFIs will benefit from a reduction in the cost of processing such returns, the cost of Regulation E dispute resolution compliance, and the cost of responding to customer complaints (call centers, branches, and online customer service). RDFIs' stop payment systems should be aided by information within reinitiation Entries that is required to be identical to the information in the original Entry.