



December 12, 2011

BY COURIER AND ELECTRONIC DELIVERY

Ms. Jan Estep, Chief Executive Officer
NACHA – The Electronic Payment Association
13450 Sunrise Valley Drive, Suite 100
Herndon, VA 20171

Re: Expedited Processing and Settlement

Dear Ms. Estep:

The Clearing House Payments Company L.L.C.¹ (“The Clearing House”) respectfully submits this comment letter in response to an invitation to comment on NACHA’s Expedited Processing and Settlement Proposal issued on September 23, 2011 (the “Proposal”). This letter also includes, as Attachment 1, a survey response that represents the specific views of EPN as an ACH Operator.

The Proposal, if approved by NACHA membership, would enable same day processing and settlement of ACH entries across the ACH network. In particular, the NACHA Operating Rules (the “Rules”) would be amended to define same day entries and make certain related changes regarding returns, reversals, and reclamations for same day entries. In addition, the Proposal anticipates that the ACH Operators would revise their processing and settlement schedules so that same day entries transmitted to them by 2:00 pm ET would be distributed to RDFIs by 4:00 pm ET and settled by 5:00 pm ET. All SEC codes and both debits and credits would be eligible for same day processing and settlement. Origination of same day entries would be voluntary but receipt and settlement would be mandatory.

The Clearing House supports the goal of improving ACH settlement speed so long as the costs and benefits of faster settlement are appropriately distributed between originators, ODFIs, RDFIs, and receivers. Assuming the needs of all participants can be balanced, we agree that faster processing and settlement could make for a more competitive network. We appreciate NACHA’s efforts to implement the goal of faster settlement while balancing the needs of all participants. However, we believe that the correct balance has not been struck in the Proposal.

¹ Established in 1853, The Clearing House is the nation’s oldest banking association and payments company. It is owned by the world’s largest commercial banks, which employ 1.4 million people in the United States and hold more than half of all U.S. deposits. The Clearing House Association is a nonpartisan advocacy organization representing through regulatory comment letters, amicus briefs and white papers the interests of its owner banks on a variety of systemically important banking issues. The Clearing House Payments Company provides payment, clearing, and settlement services to its member banks and other financial institutions, clearing almost \$2 trillion daily and representing nearly half of the automated clearing-house, funds-transfer, and check-image payments made in the U.S. See The Clearing House’s web page at www.theclearinghouse.org.

In this letter we offer a suggestion for balancing the costs and benefits of the Proposal. In addition to this suggestion, we think there are certain changes that need to be made to the details of the Proposal. Our comments follow below.

I. Executive Summary

The Clearing House suggests the following changes to the Proposal.

1. NACHA should provide a longer implementation period between ballot approval and rule effective date to accommodate financial institution and operator system changes. We suggest an 18 to 24 month implementation period.
2. The ACH Operators should determine the schedule for the submission, distribution, and settlement of same day entries.
3. To properly balance the costs and benefits of faster processing and settlement amongst all participants as well as to encourage adoption and investment in future ACH innovation, we suggest that the Proposal enable financial institutions to charge interbank compensation for processing and posting ACH entries.
4. The Proposal should require debit originators to notify consumer receivers of the possibility of same day debits to their accounts when such originators intend to originate debits as same day entries.
5. Only domestic items should be eligible for same day settlement.
6. Same day items should be identified by a field that enables ACH operators or other participants to readily recognize them.
7. Default settlement should remain next day.
8. The Clearing House supports a \$25,000 dollar cap on same day entries. The cap should be enforced by ACH Operator edit. If such an edit cannot be practicably performed, then (i) RDFIs should be permitted to return same day items that exceed the dollar cap, and (ii) in addition to warranting that same day items will not exceed the dollar cap, ODFIs should be required to edit their same day entries against the cap before submission to their ACH Operator.

II. Comments

A. Lessons Learned from the United Kingdom’s Faster Payments Service

The Proposal alludes to the U.K.’s Faster Payments Service (“other geographies . . . implementing faster processing using existing technology”) in its list of reasons why it is time to consider expediting ACH processing and settlement. We believe that Faster Payments, a near real time credit push service, provides a useful lesson in the need to balance the ideal of faster processing and settlement with thoughtful implementation. Overall we think that while Faster Payments has had positive impact for end users and has some positive attributes, it has not been implemented as fully as it could be due to certain design flaws.

It should first be noted that prior to the implementation of Faster Payments in 2008, retail electronic payments took three days to clear and settle in the U.K. Further, Faster Payments was developed in response to regulatory pressure for quicker clearing, settlement and funds availability. Today in the U.S. ACH debits and credits clear next day.² So the need for faster processing and settlement is not as pointed as it was for the U.K.

We further note that despite the clear benefits to the end users of the system, financial institutions in the U.K. cannot charge the sender or the receiver for the service. Additionally, Faster Payments presents credit risk to receiving banks as receivers are given access to funds as soon as the payment information is received by the receiving bank. However, interbank settlement can occur several hours later. Lastly, the system adopted a very high value cap of £100,000, which has proven to be much higher than many banks are comfortable with. For these reasons the service has seen spotty adoption. Specifically, some financial institutions do not participate in Faster Payments. Those institutions that do participate often limit the amount that can be sent or received at an amount significantly below the £100,000 cap. Finally, some participating institutions do not actively market the service to their customers because there is insufficient financial incentive to do so.

The U.K.’s experience with Faster Payments suggests that in order for same day ACH settlement to be successful, the Proposal must

- support a viable business case for financial institutions,
- set a reasonable dollar cap on same day entries, and
- adequately address the risks of faster processing and settlement.

² Some non-government credits settle in two days, at the choice of the originator.

B. Technical and Business Impact

1. System Changes

To implement same day ACH settlement will require significant changes across numerous bank systems. Most of these changes must be made by RDFIs to conform their systems to late day receipt, settlement, and posting. We note that settlement and posting affects many bank systems. Hence, aside from ACH and DDA platform changes, banks must make changes to their exception handling, reporting, credit processing, fraud detection and mutual fund platforms.

With respect to reporting systems, RDFIs will need to update their systems so that they can account for transactions arriving late in the banking day and generate timely and accurate available balance information for their customers via their ATM, online, and mobile channels. Further, reporting systems will need to be enhanced to ensure that periodic statements, which are required under section 205.9(b) of Regulation E, include all same day items that post to consumer accounts on or “as of” a statement cutoff date.

With regard to the costs of these necessary system changes, The Clearing House believes it is important that NACHA carefully evaluate the estimated implementation costs provided in response to the Proposal or other NACHA surveys. In particular, we think NACHA should determine whether estimates were based solely on basic ACH platform changes needed to implement the requirements of the Proposal, such as the receipt and processing of a 4:00 pm ET file, or whether the estimates included costs for changes to the systems that must synchronize with the ACH platform. NACHA should also consider whether costs like staff training and changes to customer account or service terms were included in the estimates.

Finally, it is also important that NACHA take into account the Proposal’s direct costs to financial institutions as well downstream costs to software vendors, third party processors, and receivers. For example, biller receivers may need to update their systems to accommodate late day payment posting to their customers’ accounts. Without a holistic understanding of the Proposal’s costs to all direct and indirect ACH Participants, NACHA will not have an accurate understanding of the Proposal’s impact to the ACH ecosystem.

2. Effective Date

It should also be noted that, if the suggested effective date of March 2013 is approved, the system changes noted above would need to be made alongside

other significant technological and operational changes that have been imposed by regulatory mandate and other network rules. For example,

- FinCEN has proposed mandatory electronic filing of Bank Secrecy Act reports and new electronic filing specifications for Currency Transaction Reports and Suspicious Activity Reports;
- The CFPB will issue its final Regulation E remittance transfer rules in January 2012; and
- VISA has issued several mandates that will also require changes to bank systems by the end of 2013.

With these externally imposed changes as well internal projects in mind, banks have already completed their 2012 technology development schedules and budgets. Thus, the proposed March 2013 effective date can only be met by delaying other development projects or by incurring significantly higher staffing costs. For these and other reasons noted below The Clearing House suggests at least an 18 to 24 month period between final rule approval and the effective date of same day settlement.

3. Late Day Settlement

While The Clearing House recognizes the convenience of using existing processing and settlement windows for same day processing and settlement, we are concerned that the Proposal's suggested settlement time of 5:00 p.m. ET may not be operationally feasible and presents certain risk and consumer issues. In addition, we note that deadlines for file transmission, file distribution, and settlement times are ACH Operator issues. Hence, the ACH Operators rather than NACHA should determine operational and settlement schedule for same day entries. Below are the reasons that we will consider setting an earlier settlement time.

a. Same Day Return Window.

To help mitigate the risks of same day settlement EPN will likely implement a same day return window as the Federal Reserve Banks have done in their same day service. However, a return settlement window that occurs after 5:00 p.m. will require a change to the service hours of the Federal Reserve's National Settlement Service, which is necessary for EPN settlement. Currently the service closes at 5:30 p.m. ET. Further, there needs to be enough time between the return submission deadline and return distribution deadline for an inter-operator exchange of same day return entries. A same day forward settlement deadline that is earlier in the day will better support a same day return.

b. Biller Cut Off Times

While the Proposal suggests that same day entries could be used to provide same day bill payment, payments made by credit push may not be received by a biller in time for same day credit. This is because a 5:00 p.m. ET interbank settlement time may not translate into a posting in a biller's account before the end of its business day. In particular, we note that under Regulation Z, credit card billers may establish a payment receipt deadline as early as 5:00 p.m. local time in order to credit a payment to a consumer's account on the day of receipt.³ While some RDFIs may post credits or otherwise alert biller receivers that credits are incoming prior to settlement, there is no requirement to do so. Hence, an earlier distribution and settlement time would increase the likelihood that billers would consider same day credits received before their payment cut off times.

c. Impact to Receivers

- i. For corporate receivers late day debits will be problematic. These receivers determine their funding needs much earlier in the day and may not have the ability to accommodate large debits after 5:00 p.m. ET and, thus, may incur overdrafts.
- ii. Consumer receivers also may incur overdrafts. However, if the Proposal adopts our suggestion for an originator to notify consumers when ACH debits are likely to clear same day, this notice should enable consumers to anticipate the debits and manage their account balances. The Clearing House is also concerned, as discussed below, that late day settlement may cause RDFIs to retroactively post debit entries to receiver accounts. To avoid this outcome, settlement should occur earlier in the day.

For these reasons an earlier same day schedule may be advantageous. We recognize that this may result in transmission deadlines and settlement times that do not currently exist and, thus, would require system changes for ACH Operators. However, a longer period between ballot approval and effective date will enable operators to implement the necessary changes.

4. Business Case

The Clearing House strongly supports the goal of fostering innovation with respect to the ACH network. The ACH network is extremely cost efficient

³ 12 CFR 226.10(b)(2)(ii).

relative to alternative payment networks and subject to appropriate safety and soundness standards for the types of transactions it carries. As such, the ACH system provides a strong platform for building enhanced consumer payment solutions, particularly in light of the reduced use of paper checks and the continued growth of e-commerce. However, banks will require a business case to justify the necessary capital and on-going investments to deliver innovations such as faster processing. The lack of a business case related to ACH network improvements has led to innovations at the periphery rather than the core of the network. This in turn has held back ACH growth in comparison to other electronic payments instruments.

For example, non-banks are making investments to build e-commerce and mobile “wallet” type services. These wallets have the ability to incorporate multiple underlying methods of payment (ACH, debit, credit, prepaid, proprietary). These wallet services frequently employ transactional arbitrage by charging merchants approximately 2% of the purchase price while funding the payment through an ACH debit that costs pennies to clear. Innovations that reduce timing and risk will make ACH more attractive for inclusion in such wallets services, with value accruing to the wallet provider through merchant fees, while the majority of the cost of the innovations would fall to the RDFI.

Hence, while improving ACH settlement speed is a potential first step toward fostering core, rather than periphery, ACH innovation, the Proposal must support a business model that justifies the large investment required for such core innovation. However, the business model enabled by the Proposal does not justify such investment. This is because we expect that same day settlement will primarily be used by larger businesses that want quicker settlement for their ACH entries. This quicker settlement is a value proposition that wholesale banks can offer to their business customers and will enable these institutions, if they individually choose, to differentiate their origination pricing based on same day or next day settlement.

There is no corresponding value proposition that consumer banks can offer to their consumer account holders. Further, the Rules do not enable these banks to recover their costs through charges to the wholesale banks that benefit from the Proposal. Cost recovery on the consumer bank side would, therefore, need to be accomplished either by subsidies from other business lines or by other consumer account service fees. Such a result is antithetical to a sound business case. Hence, The Clearing House believes that the Proposal must enable financial institutions to recover the costs of their implementation without internal subsidies from non-ACH sources.

In order to achieve a congruence of interests for the Proposal and foster future ACH innovations, The Clearing House suggests that the Proposal be enhanced to allow financial institutions to assess interbank fees for processing and posting ACH entries. We suggest that NACHA work with EPN and FedACH to consider how such a compensation model might work.

5. Compliance and Risk

a. IATs

The Proposal includes a requirement that same day credits be made available to receivers by the time an RDFI has completed processing for the day on which the credits were settled. The Clearing House notes that in addition to the normal reporting and fraud control functions that must be synchronized with this expedited schedule, RDFIs will have to expedite their OFAC compliance for IAT entries. In particular, RDFIs have a regulatory obligation to screen all incoming IAT entries against OFAC's Specially Designated Nationals and Blocked Persons list. Since funds cannot be made available to persons or entities included in the list, this screening will have to occur by the end of an RDFI's processing schedule for the day on which a same day entry is settled. The Clearing House believes that requiring expedited OFAC screening on top of the other expedited screening and reporting changes that must be made to facilitate same day settlement is too much. Therefore, we suggest that IATs be ineligible for same day settlement.

b. Fraudulent Payments

Faster processing, settlement, and funds availability will make same day entries attractive to those who misuse payment systems to make unauthorized or other illegal transfers. For this reason, The Clearing House supports the Proposal's imposition of dollar caps on same day entries. While we recognize that dollar caps can be circumvented by breaking a single over-the-limit payment into several under-the-limit payments and that such a cap will impede the use of same day ACH entries for legitimate purposes, we think a conservative approach is wisest.⁴ The Clearing House suggests that the cap be \$25,000.

⁴ We note that the U.K.'s Faster Payments Service imposes a scheme-level ceiling of £100,000 (approximately \$ 156,440). However, those payments are irrevocable credits, which present a different risk profile than ACH debits. Further, individual banks set their own caps based on payment type (e.g. standing order, single immediate payments, and forward dated payments) and customer type (consumer or commercial).

The Clearing House notes, however, that in order for a dollar cap to be useful, it must be enforceable by means other than a rules violation claim. Hence, the Proposal's suggestion that an ODFI simply warrant that a same day entry is below the cap is insufficient.

While we recognize that ACH Operator edits will likely be impractical without a new SEC code, which is an undesirable solution, we ask that NACHA reevaluate how same day entries will be identified and work with EPN and FedACH to determine if there is a practical way to edit same day entries. If ACH Operator edits are not practical, RDFIs should be permitted to return same day items that exceed the dollar cap. Furthermore, in addition to warranting that same day items are within the dollar cap, ODFIs should be required by rule to edit their entries against the cap before sending files to their ACH Operator.

6. Identification of Same Day Entries

The Clearing House thinks it is important that same day items be identified by a simple value, as opposed to an effective date that must be compared with the current date and time. This will enable ODFIs and RDFIs to readily recognize same day items for editing, audit, and billing purposes.

7. Inadvertent Same Day Settlement

The Proposal notes anecdotal reports from ACH Operators and financial institutions that a substantial number of ACH entries contain invalid or stale Effective Entry Dates. The Proposal further notes that the current NACHA Operating Rules provide no disincentives for such poor origination practices. The Clearing House agrees with both these observations.

To incent better origination practices, the Proposal would amend the Operating Rules to require ACH Operators to insert a Settlement Date consistent with the next available settlement window when the Effective Entry Date for a batch is stale. In contrast, the current Operating Rules require that a stale dated batch be given a Settlement Date that is the banking day following the processing date. The Rules would likewise be changed to require that ACH Operators correct blank or invalid Effective Entry Dates by inserting the current processing day's date as the Effective Entry Date. Again, this is a change from the current Operating Rules that require that the next banking day after the processing day be the Settlement Date for a batch with an invalid Effective Entry Date. As a result of these proposed changes, same day settlement would become default for entries that have defective Effective Entry Dates and that are received by an ACH Operator before the proposed 2:00 p.m. same day transmission deadline.

The Clearing House strongly disagrees with creating default or inadvertent same day settlement. Next day and second day settlement are the current norms for the ACH network. Faster settlement between banks will impact the originator and receiver and, thus, should not be imposed upon unsuspecting parties. Same day settlement should only apply when parties to a payment intend same day settlement. This is especially true for debits to a receiver's account. (See discussion below regarding receiver notice.) In addition, as an ACH Operator, we do not want unnecessary volume during the same day processing and settlement window. For these reasons we suggest that default settlement should occur on the banking day following the processing day, as the current Rules provide.

8. Consumer Issues

a. Consumer Notice of Faster Debit

If debit items are eligible for same day settlement, The Clearing House suggests that originators be required to notify consumers when originators intend to clear a consumer's payment as a same day entry. This is because consumers are not accustomed to ACH entries settling same day and such settlement will result in quicker debits to their accounts. The notice would inform consumers that funds may be debited from their account as soon as the same day so that they can manage their account balances accordingly.

Although consumers are now familiar with same day clearing for some of their checks, for ACH conversion entries (ARC, BOC, and POP) consumers are accustomed to next day clearing. The Proposal will expand the universe of consumer debits that can clear same day. As a result, consumers may suffer increases in overdraft and returned item fees. Providing consumers with notice to alert them to same day settlement will mitigate the risk of overdrafts and the reputation risk to financial institutions that can follow such unfortunate experiences.

This notice would be consistent with the approach taken with respect to check to ACH conversion entries by the Federal Reserve Board of Governors in the staff commentary to Regulation E in 2007. Similar to the Regulation E approach, the requirement to provide notice of possible same day debits could sunset after same day ACH settlement becomes routine.

b. Retroactive Debits

The current NACHA Operating Rules enable an RDFI to debit a receiver's account once the RDFI has settled for the debit.⁵ However, given the Proposal's 5:00 p.m. settlement time, an RDFI may not be able to post a debit to a receiver's account on the settlement date due to processing schedules that may extend into the next calendar day. The Proposal recognizes this possibility in its discussion of credit availability.

The Clearing House is concerned that there may be negative consumer impact if, as has been proposed for credits, debits post after the settlement date but are made retroactive to the settlement date. While RDFIs would be entitled to make debits retroactive, it is likely that consumers would object to this practice. Given recent regulatory attention to overdraft programs and DDA posting order⁶, The Clearing House suggests that same day settlement occur early enough in the day to enable RDFIs to post a debit on the settlement date or that the Rules prohibit retroactive debit posting.

c. CFPB Involvement

The Clearing House recommends that NACHA discuss the Proposal with the CFPB in case the agency has any concerns regarding consumer impact. Additionally, inasmuch as the CFPB has jurisdiction over Regulation E as an "enumerated consumer law" under the Dodd-Frank Wall Street Reform and Consumer Protection Act,⁷ NACHA may wish to ask whether the expedited processing and settlement under the Proposal constitute a new electronic fund transfer triggering disclosure requirements under Regulation E section 205.7 as to new and existing consumer customers. If this is the case, NACHA may wish to include information regarding this regulatory obligation to alert financial institutions to this requirement.

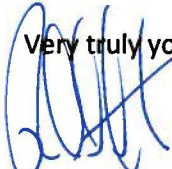
* * * * *

⁵ NACHA Operating Rules 3.3.2 (Timing of Debit Entries)

⁶ See the OCC's proposed overdraft guidance at 76 Fed. Reg. 33409 (June 8, 2011) and the FDIC's final overdraft guidance (Financial Institution Letter 81-2010)..

⁷ Public law 111-203, 124 Stat.1376 (2010).

Thank you for the opportunity to comment on the Proposal. If you have any questions or wish to discuss The Clearing House's comment letter, please do not hesitate to contact me.

Very truly yours,

Russ Waterhouse

Executive Vice President
The Clearing House Payments Company, L.L.C.
(212) 613-0171
Russ.Waterhouse@theclearinghouse.org