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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: NACHA Proposals to Improve Network Quality

Dear Ms. Estep:

The Clearing House Association L.L.C. and The Clearing House Payments Company L.L.C., including the members of its regional payments association (The Clearing House Payments Association), (together "TCH") respectfully submit this letter in response to an invitation to comment on NACHA's Proposed Rules to Improve ACH Network Quality, issued on November 11, 2013 (the "Proposal"). Please note that in addition to this letter The Clearing House Payments Association and The Clearing House Payments Company (as operator of EPN) will each also provide responses to the ACH participant surveys included in the Proposal.

I. Executive Summary

As more fully discussed below, TCH supports NACHA's goal of improving the quality of the network through new return limits, enforcement authority, quality fees, and clarified re-initiation rules. However, we have the following suggestions in response to the Proposal:

- To protect legitimate originators that may exceed the new invalid account and overall return limits for valid reasons, the return limit investigation and enforcement regime should be revised to include both (i) objective criteria for assessing whether an originator or third party sender has valid reasons for being above a return limit and (ii) a consultative process in which representatives of financial institutions and NACHA together apply the criteria to the particular business circumstances and ACH practices of an originator or third party sender and determine whether the originator or third party sender should be allowed to remain above the limit.

- NACHA's new authority to bring an enforcement action for unauthorized activity that is independent of the return limit regime (i) should not be based solely on NACHA's reasonable belief of improper authorization but on the recommendation of a group that includes both NACHA staff and representatives of financial institutions and (ii) should require that there be an element of materiality or repetitive misconduct to the unauthorized activity.

- The NACHA Rules should expressly define "proper authorization" to mean that that receiver has provided an actual authorization for a debit or credit to his or her account and that such authorization for debit or credit is clear and readily understandable.

- In addition to clarifying the requirements for re-initiation of entries, it is equally important that NACHA and the industry undertake an effort to educate ODFIs and originators about proper re-initiation practices as we think many re-imitation problems result from a lack of understanding about what the Rules require.

- As neither the proposed company entry description for reinitiated entries nor the rules clarifications will prevent unscrupulous originators from evading the limits on reinitiation it is important that NACHA be clear in its communications with regulators and the public that the Proposal is not a solution to improper reinitiation. Further, NACHA should also be clear that the Proposal imposes no new substantive obligations on ODFIs or originators.

II. Return Limits

To reduce misuse of the ACH network and to improve origination quality NACHA proposes to reduce the current unauthorized return rate limit for debit entries from 1% to .5%[1] and to create two new return rate limits for debit returns. The first new limit would be a 3% rate of return for invalid account reasons.[2] The second new limit would be a 15% rate for all debit returns other than returns of RCK (returned check) entries.

While we do not have sufficient information at this time to comment on the specific rates NACHA has proposed,[3] it is logical to expect that lowering the existing unauthorized return limit and creating new kinds of return limits will result in more originators exceeding network limits than exceed the current limit today. We anticipate that some of these additional originators will be "outliers" whose return rates are "indicative of fraud or poor-quality origination," as NACHA describes in the Proposal.[4] We also anticipate, however, that some of the additional originators who exceed the 3% invalid account limit and 15% overall limit will be outliers for legitimate reasons.

The current return limit enforcement regime provided in Appendix Ten of the NACHA Rules is predicated upon NACHA's ability to request information from any ODFI that NACHA "in its sole discretion . . . believes" has originated entries for an originator or third party sender that has exceeded the unauthorized return limit.[5] NACHA generally forms its belief that an originator has exceeded the current unauthorized limit based upon weekly reports from EPN and FedACH that identify originators who

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[1] The Proposal would include return reason code R37 (Source Document Presented for Payment), which is used to return certain check conversion entries, with the other return reason codes that have historically counted towards the unauthorized return limit.

[2] Specifically, the 3% limit would include return reason codes R03 (No Account/ Unable to Locate), R04 (Invalid Account Number Structure), and R20 (Non-Transaction Account).

[3] As we have previously communicated to NACHA, we are still in the process of applying the proposed rates to EPN data and plan to provide more specific feedback on the proposed rates in the near future.

[4] ACH Network Risk and Enforcement Topics, Rules Proposal Description, p.2.

[5] Subpart 10.2.1 (ODFI Reporting Requirements), Appendix Ten, NACHA Rules.

receive certain categories of returns above certain amounts. If, in response to NACHA's request for information, an ODFI determines that its originator or third party sender is in fact above the network limit, the ODFI must provide NACHA with a "detailed plan and timeline" for reducing the rate under the network limit.[6] If the ODFI fails to reduce the originator or third party sender's rate below the limit or keep the rate below the limit for 180 days, NACHA may initiate a rules enforcement action against the ODFI.[7]

Because NACHA's ability to initially request return rate information from an ODFI and to ultimately bring an enforcement action are within NACHA's sole discretion and based only upon an originator's or third party sender's rate of return, we are concerned that originators who are outliers for legitimate reasons will have no defense against potential NACHA investigations. Moreover, to the extent that NACHA sees certain originators on the EPN and FedACH weekly reports but chooses not to request return rate information about them because those originators are deemed to have permissible ACH activity, we are concerned that this will leave NACHA and the network open to criticism that NACHA is only enforcing return limits against certain kinds of businesses. Therefore, we think that the Rules need to articulate objective criteria for assessing whether an originator or third party sender has valid reasons for being above a return limit. While we do not have specific suggestions as to what these criteria should be at this time, we will provide these suggestions once we have had an opportunity to apply the rates to EPN data and see what kinds of originators exceed the 3% invalid account and 15% overall limits.

We also think that NACHA should follow a transparent consultative process in applying the criteria to a particular originator or third party sender. In particular we suggest that representatives of financial institutions participate in the review of an over-the-limit originator's or third party sender's business circumstances and ACH practices and in the determination as to whether the entity should be allowed to stay above the limit. The Rules Enforcement Panel could be used for this purpose.

Finally, we think it will be necessary to exclude originators who originate less than a minimum volume of transactions per month. Return rates that are calculated on low forward volumes are unreliable indicators of problematic origination and, thus, will not be helpful to improving network quality. We expect to have a more specific recommendation regarding what the minimum volume should be after we have evaluated our data.

III. Enhanced Enforcement for Unauthorized Entries

Currently NACHA's ability to initiate enforcement actions against ODFIs and originators for high levels of unauthorized activity (as evidenced by high rates of unauthorized returns) is dependent upon an ODFI's failure to meet certain obligations under Part 10.2 (ODFI Reporting Requirements) of Appendix Ten of the NACHA Rules. Specifically, NACHA is limited to initiating enforcement actions related to unauthorized entries in three circumstances: (i) if an ODFI fails to provide complete and accurate return rate information in response to NACHA's request for such information; (ii) if an ODFI fails to reduce a return rate below the 1% limit within 30 days of providing information to NACHA that substantiates the rate is above the limit; and (iii) if an ODFI fails to keep a return rate below 1% for 180 days after reducing the rate in response to a NACHA investigation. As NACHA notes in the Proposal, unauthorized entries adversely impact the reputation of the ACH network and RDFIs and NACHA are sometimes faulted for

[6] Rule 2.17.2.1 (Additional ODFI Action and Reporting When Return Threshold is Exceeded), NACHA Rules.
[7] Subpart 10.4.3 (Submission Requirements for Rules Enforcement Proceedings initiated by the National Association), Appendix Ten, NACHA Rules.

the problematic ACH activity of originators and their ODFIs. However, the current ODFI reporting and remediation regime provided in Part 10.2 takes many weeks, if not months, to play out before NACHA can bring an enforcement action against a problematic originator or ODFI. Given the heightened public and regulatory awareness of the ACH network it would be beneficial for NACHA to be able to act more quickly in response to concerns that the network is being misused.

For these reasons, NACHA proposes to expand its enforcement authority related to unauthorized entries by revising Part 10.4.1 (Initiation of Proceedings) to enable NACHA to bring an enforcement action if NACHA "has reasonable belief that an ODFI, Third Party Sender, or Originator has originated Entries without proper authorization."[8] TCH agrees that it is necessary for NACHA to be able to bring enforcement actions for unauthorized entries more quickly than the current process allows and therefore supports the proposed additional authority to initiate enforcement actions for unauthorized entries without having to first establish that the unauthorized return limit has been exceeded and that the ODFI has failed to reduce the rate within 30 days or to keep the rate reduced for 180 days.

We do, however, think that the "reasonable belief" of improper authorization should be based upon a recommendation by a group that is comprised of both NACHA staff and representatives of financial institutions. It is possible NACHA could utilize the existing Rules Enforcement Panel for this purpose. We acknowledge that the recommendation process would need to be expedited so as not to hinder NACHA's ability to act quickly to address unauthorized activity. Additionally, we suggest that the meaning of proper authorization be expressly defined in the NACHA Rules to mean that that receiver has provided an actual authorization for a debit or credit to his or her account and that such authorization is clear and readily understandable. Proper authorization for an ACH entry, which is a central concept for the ACH rules, should relate solely to the ACH entry itself (i.e. the debit or credit to a bank account) and be clearly distinct from the transaction or purpose underlying the payment.

We also think that an element of materiality needs to be added to the proposed authority. Otherwise, there may be a public or regulatory expectation that NACHA bring enforcement actions any time it has a reasonable belief that even a single entry has been returned as unauthorized. We would suggest that the proposed language be revised to say that there is a reasonable belief that either (i) there has been material harm or loss to receivers because an ODFI, third party sender, or originator has originated entries without proper authorization, or (ii) an ODFI, third party sender or originator has demonstrated an ongoing practice of originating entries without proper authorization.

Lastly, we think the proposed drafting would be clearer if it stated expressly that NACHA can bring an enforcement proceeding for unauthorized entries even if it has not established through the ODFI reporting requirements that an ODFI, third party sender, or orginator has exceeded the unauthorized limit.

IV. Re-initiation

The Proposal also includes a number of suggested rules revisions to prevent problematic re-initiation practices, such as reinitiating entries returned for insufficient funds more than two times, disguising reinitiated entries by changing the amount or payee name, and reinitiating entries returned as unauthorized without a new authorization to do so. NACHA proposes to address problematic re-

[8] ACH Network Risk and Enforcement Topics, Proposed Modifications to the Rules, p.15.

initiation practices through a requirement to identify reinitiated entries and clarification of the NACHA Rules.

A. Identification

The Proposal would identify reinitiated entries by requiring creation of a separate batch for reinitiated entries, which would include the word "REDEPOSIT" in the company entry description field of the company/batch header record. NACHA explains that this requirement "will facilitate research and dispute resolution for RDFIs."[9] TCH disagrees with this statement because we think that unscrupulous originators will ignore the requirement to separately batch and identify reinitiated entries. Such originators will continue to try to disguise reinitiated entries. Hence, we do not think that the separate batches and special company entry description will be a reliable way for RDFIs to identify or investigate problematic re-initiation.

Nonetheless, *to the extent that compliant originators identify reinitiated entries*, we do think that a specific company entry description will be helpful to receivers. In particular, a description that informs receivers on their online transaction histories and account statements that a particular debit relates to a previous attempt to debit their account for an amount owed to the originator should make the purpose of the debit more clear. This, in turn, may potentially reduce inquiries from receivers to their financial institutions.

In order for the description to be helpful to receivers, it needs to convey that a debit entry to their account relates to a previously returned or rejected debit to their account. We do not think the proposed description "REDEPOSIT" conveys this idea. Rather, the term will confuse receivers as a debit to their account is neither a deposit nor a redeposit. We suggest instead that NACHA form a work group to find a term that will be clear and meaningful to receivers.

Because a company entry description for reinitiated entries will have some benefit for receivers, TCH supports the proposal. However, we think it is important that NACHA be clear in its communications with regulators and the public that the identification of reinitiated entries is dependent upon the compliance of originators. Thus, the company entry description should not be characterized as a means to prevent problematic reinitiation practices.

B. Rules Clarification

NACHA proposes to clarify the NACHA Rules by

- Creating new terms "Reinitiated Entry," "Reinitiation," and "Reinitiate," defined[10] in Article 8 of the NACHA Rules (proposed new Rule 8.78);
- Creating new formatting requirements (proposed new Rule 2.12.4.2) for reinitiated entries specifying that the entries must be in the same amount and use the same Company Name, and Company ID as the original entry; and
- Describing inappropriate re-initiation practices (proposed new Rule 2.12.4.3) as

[9] ACH Network Risk and Enforcement Topics, Rules Proposal Description, p.8.

[10] The proposed definition of these terms would be "Following the Return of an Entry, an Entry initiated to the same Receiver's account in the same amount in payment or fulfillment of the same underlying obligation." ACH Network Risk and Enforcement Topics, Proposed Modifications to the Rules, p.10.

- Initiating an entry for a larger amount, or one or more entries for smaller amounts, in payment or fulfillment of the original returned entry;
- Reinitiating an entry returned as unauthorized; or
- Initiating any entry that attempts to circumvent limits on reinitiation.

TCH thinks that these revisions to the NACHA Rules will help to clarify when entries should and should not be reinitiated and therefore supports the revisions. However, as a material portion of the improper reinitiation that occurs today is due to originators that do not understand reinititation requirements, we think it is equally important that NACHA and the industry undertake an effort to educate ODFIs and originators about proper reinitiation practices. Additionally, to avoid any misunderstanding that these changes are imposing new substantive requirements, we again ask that NACHA be clear in its communications to regulators and the public that the clarifications do not change requirements regarding reinitation and do not impose new obligations on ODFIs or originators.

C. Returns

Lastly, the Proposal notes that there is not currently a separate return reason code for improperly reinitiated entries. For this reason NACHA proposes that code R10, which is used for unauthorized returns and has a 60 day return deadline, be used for return of improperly reinitiated entries since it is unlikely that RDFIs will discover an improperly initiated entry within the usual 2 day return window. NACHA has requested comment as to whether a written statement of unauthorized debit should be required for these returns or whether such a requirement may be unecessarily burdensome for receivers who have already provided a statement with respect to an initial unauthorized entry or for multiple improper reinitiations of an entry.

We agree that improperly reinitiated entries should have a 60 day return deadline to allow consumer receivers sufficient time to review their account statements and report the entries. Additionally, we think it would be helpful to further clarify in Part 4.2 (Table of Return Reason Codes) of Appendix Four of the rules which return reason code should be used when returning improperly reinitiated entries.

We do not think that R10 is the correct code to use for return of reinitiated entries since such returns are not premised upon receivers' claims that the entry were unauthorized. Rather the returns are premised upon a violation of the requirements for re-initiation. Consequently, a written statement of unauthorized debit is inapplicable to these returns and should not be required. There are three return reason codes that have a 60 day return time frame and that do not require a written statement of unauthorized debit.[11] We think one of these codes should initially be used for improperly reinitiated entries. Longer term NACHA should consider creating a new R-code for returns of reinitiated entries so that the return reason is clear and trackable.

V. Third Party Obligations

NACHA proposes to make express the requirement that Third Party Senders perform the obligations that apply to ODFIs under Rule 2.2.2. This rule requires that ODFIs establish, implement, periodically review and enforce exposure limits for their originators and third party senders. More specifically, it requires

[11] The three codes are R33 (Return of XCK Entry), R38 (Stop Payment on Source Document), and R52 (Stop Payment of Item Related to RCK Entry).

ODFIs to monitor origination and return activities of originators and third party senders, enforce restrictions on the types of entries that may be originated, and enforce exposure limits.

TCH supports this clarification. We also think that the NACHA Rules should expressly require third party senders to manage the return rates of their originators in addition to monitoring return rates. This is necessary because while ODFIs, as insured financial institutions, are subject to FFIEC guidance that requires them to manage the return rates of their customers (originators), there is no such regulatory guidance that applies directly to third party senders. Nor is there any provision in the NACHA Rules that requires ODFIs to manage the return rates of their originators. Hence, to require third party senders to perform the same obligations as ODFIs perform *under the NACHA Rules* when there is no ODFI requirement in the rules to manage return rates, creates a loophole for third party senders. Namely, third party sender can meet their obligations under the NACHA Rules by monitoring (being aware) of their originators' return rates yet have no obligation to manage those rates within network limits. Given the prevalence of third party senders in the network, we think it is important to hold them to the same standards as ODFIs with respect to the return rates of their originators.

NACHA also proposes that it be able to request directly from ODFIs documentation supporting completion of audits by third party senders and third party service providers. TCH supports this revision.

VI. Quality Fees

To reduce the occurrence of certain kinds of returns and exceptions NACHA proposes to establish fees, which would be paid by ODFIs to RDFIs, to enable RDFIs capture some of their costs for exception processing and customer service and to incent ODFIs to work with their originators and third party senders to improve origination quality. Specifically NACHA is proposing three fees.

1. An Erroneous Data Fee for entries returned as R02 (Account Closed), R03 (No Account/Unable to Locate Account), R04 (Invalid Account Number Structure), R20 (Non-Transaction Account), R24 (Duplicate Entry), R39 (Improper Source Document/Source Document Presented for Payment), and R50 (State Law Affecting RCK Acceptance). NACHA notes that there were 46.3 million returns using these codes in 2012.
2. A NOC Fee for notifications entries sent for change code reasons C01 (Incorrect DFI Account Number), C05 (Incorrect Transaction Code), C06 (Incorrect DFI Account Number and Incorrect Transaction Code), C07 (Incorrect Routing Number, Incorrect DFI Account Number, and Incorrect Transaction Code), C08 (Incorrect Receiving DFI Identification for IAT), C09 (Incorrect Individual Identification Number/Incorrect Receiver Identification Number), C13 (Addenda Format Error), and C14 (incorrect SEC Code for Outbound International Payment). According to NACHA in 2012 there were 11.5 million NOCs with these codes.
3. An Unauthorized Entry Fee for entries returned as R05 (Unauthorized Debit to Consumer Account Using Corporate SEC Code), R07 (Authorization Revoked), R08 (Payment Stopped), R10 (Customer Advises Unauthorized), R29 (Corporate Customer Advises Not Authorized), R37 (Source Document Presented for Payment), R38 (Stop Payment on Source Document), R51 (Item Related to RCK Entry is Ineligible or RCK Entry is Improper), R52 (Stop Payment on Item Related to RCK Entry), and R53 (Item and RCK Entry Presented for Payment). NACHA notes that in 2012 there were 6.4 million returns based on these codes.

NACHA is also requesting information regarding a potential fee for a new type of NOC in which a RDFI provides a positive response to a pre-notification entry, informing the ODFI and originator that the account information contained in the pre-notification entry is correct.

TCH agrees with the concept of incenting improved origination practices through ODFI-paid fees that partially compensate RDFIs for the costs they incur in handling certain returns and exceptions. While we have no comment on how much the fees should be, we think that putting in place an initial fee structure will allow network participants to test how ODFIs, originators, and third party senders change their behavior in response to the additional costs associated with the returns and exceptions they create. The fee structure can then be adjusted over time to refine the impact of the fees.

While we support all three fees, we note that with respect to the Erroneous Data Fee and NOC Fee we have some concern that ODFIs may be assessed fees in situations in which the receiver's account data is erroneous due to a merger or acquisition of the receiver's financial institution or due to the receiver providing incorrect account data to the originator. While we understand that part of the reason NACHA proposed fees that do not wholly compensate for median industry costs for handling these exceptions is in recognition that in some instances NOCs and erroneous data returns will result from RDFI and receivers issues, we also think NACHA should consider eventually creating new C-codes to account for merger related changes. This would enable NOCs related to mergers to be excluded from the fee.

With respect to NOCs and returns that result from incorrect account data provided by receivers, we note that there is currently no means by which an originator or ODFI can validate the account number of all potential receivers. Therefore, we are supportive of the idea of charging a fee for a positive verification of account data within a pre-notification entry. Given that such positive verifications are a means for ODFIs to avoid the Erroneous Data Fee and NOC Fee we think NACHA should consider making such a fee effective at the same time as those fees become effective, or even prior to the time they become effective. We also encourage NACHA to continue to explore ways to enable originators and ODFIs to validate receiver account numbers prior to origination.

VII. Split Transactions

NACHA has requested comment on whether there is interest in revising the NACHA Rules to provide employers and their RDFIs the ability to return a debit entry from a payroll processor when the processor fails to distribute some or all of the payroll payments that the debit entry was intended to fund. NACHA notes that this situation is similar to Incomplete Transactions, which apply to split transactions in which consumers intend to pay another party through a payment intermediary but the intermediary fails to pay the intended party. NACHA further notes that consumers are the ultimate beneficiaries of payroll payments.

TCH strongly disagrees with and does not support the concept of allowing a commercial receiver (employer) to return a debit related to an incomplete payroll transaction. Commercial entities should perform due diligence on the entities with which they do business and determine whether those entities are financially sound and trustworthy service providers. Moreover, employers should assess the risks related to using a payroll processor that acts as a payment intermediary and protect themselves through contract from such risks, including the potential insolvency or misconduct of the processor. The ACH network should not be asked to solve for commercial issues that are external to the functioning of the network. The fact that consumers may be the ultimate beneficiaries of payroll transactions should not be a justification for shifting risk of commercial loss from an employer to an ODFI.

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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,

David S Fortney

Dave Fortney
Senior Vice President
The Clearing House Payments Company, LLC
(212) 613-0156
dave.fortney@theclearinghouse.org