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May 2, 2014

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 (together, "TCH") appreciate the opportunity to provide additional comments on NACHA's Proposed Rules to Improve ACH Network Quality, issued on November 11, 2013 (the "Proposal"). This letter supplements the comments we provided in our letter to NACHA, dated January 13, 2014, regarding the Proposal (the "Initial Letter").

As noted in the Initial Letter, TCH committed to provide further feedback on two matters referenced in the Proposal following further research and analysis of certain EPN data. The first matter was in reference to the proposed return rates for (i) unauthorized returns, (ii) debit returns for erroneous data (invalid accounts) and (iii) overall debit returns other than returns of RCK (returned check) entries. The second matter was in reference to suggestions for objective criteria to be applied to Originators or Third-Party Senders that exceed the proposed erroneous data or overall return rates. TCH has completed its research and analysis with respect to these matters and is pleased to provide the following recommendations as further described below.

I. Executive Summary

- Based upon our analysis of the proposed 3% erroneous data and 15% overall (excluding RCK) return rates, it is clear that *these rates do not provide conclusive proof that an Originator or Third-Party Sender is engaged in misconduct or poor origination practices*. Hence, these rates should not function as limits but rather as triggers for additional review.

- An Originator or Third-Party Sender with return rates above the 3% erroneous data or 15% overall trigger should not be required to immediately reduce their rate below the applicable threshold, but instead, as further described in this letter, be subject to a review process that will include, but not be limited to, objective criteria specified in the network rules.

- TCH supports the proposed 0.5% unauthorized rate applied to Originators or Third-Party Senders that have more than a to be determined minimum volume of activity.

- TCH supports the 3% erroneous data and 15% overall returns rates as triggers for network review, subject to their application to Originators or Third-Party Senders that have more than a to be determined minimum volume of activity.

II. TCH Findings and Recommendations

A. Return Rates and Minimum Volumes

1. General Observations

While ODFIs, as the gatekeepers of the network, have primary responsibility for knowing their customers, evaluating and mitigating risks of their customer's activities, and on-going monitoring of their customers' activities, industry self-regulation through network rules is an important backstop for instances in which ODFIs are not properly fulfilling their gatekeeper responsibilities. TCH agrees with the view expressed by the Consumer Financial Protection Bureau in its January comment letter to NACHA that, "Industry self-regulation, implemented lawfully and effectively, can reduce the need for government intervention through regulation, supervision, or enforcement actions."[1] Hence, we think it is important that NACHA be able to effectively investigate and, when appropriate, bring action against network participants engaged in the kinds of misconduct or poor origination practices that the proposed new return rates are designed to identify. In other words, new return rates alone, without meaningful network monitoring and rules enforcement, will not prevent problematic conduct in the network and may subject the network, including financial institutions, to burdensome and impractical government intervention.

Key to NACHA's effectiveness will be structuring the new return rates, including, as discussed below, minimum volumes, to reduce the "noise" of identifying entities that are not engaged in problematic conduct as much as possible while still identifying problematic outliers. Striking this balance will be critical to ensuring that a manageable number of entities are identified for review and that NACHA is devoting its resources to review of the entities that present the most likely risk of misconduct or poor origination practices.

2. TCH Data

TCH analyzed unauthorized return rates based on all entries EPN processed in May 2013. We also analyzed erroneous data and overall return rates based on all entries EPN processed in June 2013. We excluded Originators with less than ten forward entries from our analysis.[2]

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[1] *See* Consumer Financial Protection Bureau, Letter to NACHA – The Electronic Payments Association, dated January 13, 2014.

[2] This analysis excludes Originators of fewer than ten entries per month to avoid a statistical effect that might overstate the prevalence of Originators with high return rates. Because the minimum quanta of returns is 1 and the number of low-volume Originators is high, normal variance will result in a significant number of Originators exceeding return rate thresholds in any given period due to an unexceptional occurrence of returned entries. To illustrate this effect, assume that 1,000 small Originators each originate 10 entries per month. If we assume that these Originators collectively receive 100 returns for Erroneous Data, the average return rate is 1%, well below the target threshold. Because the minimum number of returns any Originator can receive is 1, any Originator that receives a return will have a return rate of 10%, much higher than the threshold.

We note that because our analysis is based only on EPN entries, our research may overstate or understate return rates for some Originators. For example, if an ODFI originates some entries through FedACH that are destined to FedACH RDFIs, but receives returned entries from these RDFIs through EPN, the EPN data would overstate the return rates.[3]
In addition, our analysis may understate the number of returned entries for some Originators. Entries originated through FedACH to FedACH RDFIs that are returned through FedACH are not included in our data. This may result in some Originators incorrectly falling below the monthly return volume threshold for some analyses.

We also note that we identified Originators by the Company Name field. This may cause our analysis to overstate the incidence of companies exceeding return rate thresholds. Originators using multiple company names for different purposes may exceed the return rate threshold for entries originated under one Company Name while their overall rate across all Company Names is below the threshold.

Finally, we note that FedACH data, data relating to "on-us" and direct exchange transactions have not been factored into our analysis as our research was based solely on EPN entries.[4]

3. Need for minimum volumes

As mentioned above, ODFIs have primary responsibility for knowing and managing their originators and, thus, to monitor the return rates for all of their Originators, regardless of their origination volumes. The network serves as a backstop to identify and, when appropriate, enforce network rules when ODFIs are not properly fulfilling their gatekeeper responsibilities or are themselves violating network rules. However, in carrying out its network-backstop role, NACHA cannot perform the same level of monitoring as individual ODFIs. Thus, we think it is necessary for NACHA to limit its monitoring of return rates to entities that exceed a minimum volume of ACH activity.

We believe that the proposed return rates will need to be applied to Originators that exceed minimum volumes because a relatively small change in the number of returns can have an outsized impact on the return rate of a small Originator. For example, for an Originator with forward volume of 10,000 entries, an additional 10 returns equals a 0.1% change in the return rate. For an Originator with 100 entries, every additional return equals a 1% increase in the return rate. The effect is that for the thousands of low-volume Originators, random chance would create a significant number of "suspects" each month simply because the minimal incremental unit of return volume has a material impact on the return rate.

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[3] We estimate that this scenario of an intra-FedACH forward item being returned as an inter-operator item may increase the calculated return rate for overall returns by 2-3 percentage points, the erroneous data return rate by 0.5-0.6 percentage points and the unauthorized return rate by approximately 0.1 percentage point.

[4] We note that information relating to "on-us" and direct exchange activities are not reflected in the ACH operator reports available to NACHA and that visibility with respect to these types of "off-network" activities is limited. As the public and regulators do not distinguish "off-network" from "on-network" activity when they consider the impact of problematic originators on consumers, NACHA may in the future wish to consider ways to gain further visibility on these types of activities and the rate of returns associated with such activities.

Accordingly, TCH recommends that a minimum volume threshold be established for each of the proposed return rates. We believe that the minimum volume thresholds should be proportional to the return rate thresholds for each type of return. This is because at higher return rates, the number of returns generated at the threshold rate will be proportionately higher than the number of returns at a lower threshold rate for the same sized Originator. For example, if an Originator with 10,000 forward items was at the threshold rates proposed by NACHA for Unauthorized, Erroneous Data and Overall returns, they would generate 50 Unauthorized returns, 300 Erroneous Data returns and 1,500 total returns.

We suggest that minimum volume thresholds be determined by NACHA in consultation with the ACH operators in the first instance and then monitored by NACHA on an ongoing basis, with adjustments to the volume thresholds made from time to time following appropriate feedback from ODFIs and other members of the ACH network.[5] TCH would be pleased to further discuss the proposed minimum volume thresholds with NACHA and to assist NACHA in identifying what the appropriate volume threshold for each return rate contemplated under the Proposal should be.

Finally, we note that excluding low volume Originators from network level return rate monitoring does not mean that ODFIs would be exempt from monitoring the return rates of their low volume Originators or that such Originators would be immune from the rules enforcement regime. Under NACHA's proposed enhanced enforcement authority, NACHA will be able to investigate and bring action against low volume Originators that are engaged in misconduct but are not reviewed under the new return rates.

4. Unauthorized limit

At a minimum volume of 50 returns, approximately 85 Originators exceeded the 0.5% unauthorized rate, of which 40 Originators were above a 0.5% rate and less than 1% rate (and, hence, would not have exceeded the current 1% rate.) The largest share of the new over-the-limit Originators appears to be consumer lenders. Although the lower unauthorized limit only appears to identify a few additional Originators, we think it will be helpful in preventing misuse of the network and, hence, we support the proposed 0.5% rate.

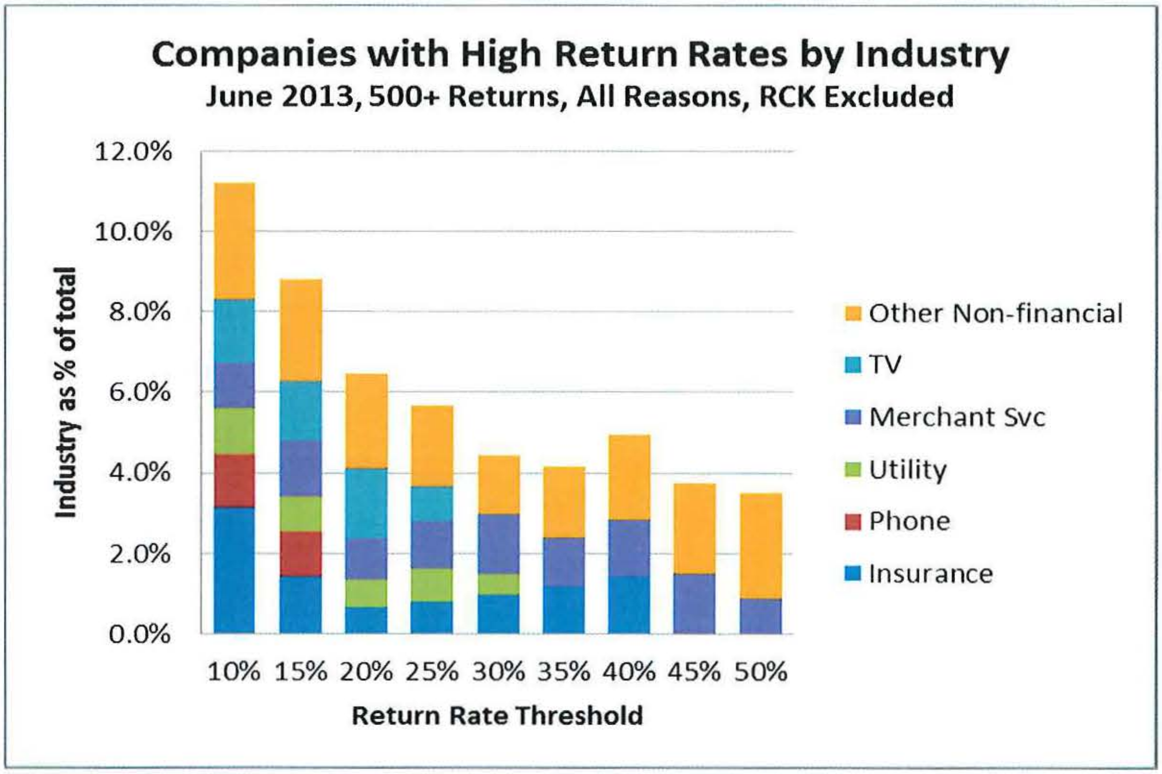
5. Erroneous data review trigger

At a minimum volume of 100 returns, approximately 200 Originators exceeded the 3% erroneous data rate, of which approximately half do not appear to be engaged in high-risk activities. While raising the minimum volume of returns to 250 or 500 returns reduces the total number of Originators that are above the 3% rate from 200 to approximately 90 and 40, respectively, the ratio of Originators that do not appear to be engaged in high-risk activities remains at approximately half. Given the prevalence of Originators that are not in high-risk industries that will be identified by the 3% rate, we do not think that the 3% rate alone can serve as the basis for determining that an entity is engaged in misconduct. Nonetheless, we think the rate can be a useful tool in identifying Originators that should be reviewed to determine if their origination practices can be improved or if they are engaged in misconduct. Hence, subject to the rate's use as a review trigger and not as network limit, we support the proposed 3% erroneous data rate.

[5] We suggest that the minimum volume thresholds be memorialized in agreements between the operators and NACHA but not be published in the network rules so as to avoid the ability for network participants to "engineer" around the thresholds.

6. Overall return rate[6]

TCH analyzed Originators that exceeded return rates from 10% to 50%. We found no natural break point in these rates that clearly separated "normal" returns from "excessive" returns. While the total number of Originators with return rates in excess of an overall return rate decreased as the overall return rate increased, the proportion of Originators that do not appear to be engaged in high-risk activities remained steady. Hence, we do not think that any particular overall return rate can serve as the sole basis for determining that an entity is engaged in misconduct. Similar to our position regarding the erroneous data return rate, we think the overall return rate can serve as a useful tool to identify Originators that should be subject to network review to determine whether they are engaged in poor origination practices or misconduct. Hence, subject to the rate's use as a review trigger and not as network limit, we support the proposed 15% overall return rate.



**Source:* Analysis of ACH entries processed by EPN in June 2013 for companies originating more than 10 entries.

Specifically, with regard to a 15% overall rate approximately 350 Originators exceeded the threshold, of which approximately 8% do not appear to be engaged in high risk activities. Keeping the rate at 15% but increasing the minimum volume of returns from 500 to 1000, 2000, or 4000 increases the ratio of Originators that do not appear to be engaged in high-risk activities.

[6] Consistent with NACHA's proposal, we excluded RCKs from our count of returns for overall rates.

B. Framework for Originators that Exceed the Erroneous Data or Overall Return Rates

As explained in the Initial Letter, the current framework for the unauthorized limit set out in the NACHA Rules provides that if, in response to NACHA's request for information, an ODFI determines that its Originator or Third-Party Sender is in fact above the unauthorized limit, the ODFI must provide NACHA with a "detailed plan and timeline" for reducing the rate under the network limit.[7] 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.[8] Such rules enforcement actions can ultimately lead to fines for an ODFI and network wide suspension for an Originator or Third-Party Sender, if rates are not reduced and maintained below the network limit.[9]

As explained above, our review of EPN data found that Originators that do not appear to fall into high-risk categories exceed the 3% and 15% rates. For example, insurance companies, utility companies, television service providers, telecommunications providers and even state governments exceeded the 3% rate. The same kinds of Originators as well as Originators from other industries that have not historically had high incidences of fraud or controversial origination practices exceeded the 15% rate. Hence, we think that a different framework than the unauthorized limit framework needs to apply to entities that exceed the 3% or 15% rate.

We suggest that an ODFI's report to NACHA under section 2.17.2 (ODFI Reporting Requirements) of the Rules that an Originator or Third Party Sender has exceeded the 3% or 15% rate should not be considered a Rules violation. Rather, we suggest that such a report should serve as a basis for NACHA to review the origination and business practices of the Originator or Third Party Sender as well as the on-boarding and monitoring practices of the ODFI. Once NACHA has completed this review, it would then make a recommendation to the ACH Rules Enforcement Panel that the Originator or Third-Party Sender either reduce their return rate below the applicable rate or be permitted to stay above the applicable rate. It would be the ACH Rules Enforcement Panel's responsibility, based upon NACHA's recommendation and review of the information NACHA has gathered regarding an Originator or Third-Party Sender, to determine whether to require the Originator or Third-Party Sender to lower their rate below the applicable rate.

With respect to the review of the Originator or Third Party Sender, we propose that NACHA include the following objective factors in its review:

- whether the Originator offers a utility service, such as electricity, gas, internet, or telecommunications, to customers who are low to moderate income (such factor to be a mitigating factor);

- whether the Originator or Third Party Sender, its principals, entities with which its principals are or have previously been associated, or its current affiliates have or have been the subject of:

    - investigations, regulatory actions, or legal actions by state or federal authorities; or

[7] Rule 2.17.2.1 (Additional ODFI Action and Reporting When Return Threshold is Exceeded), NACHA Rules.
[8] Subpart 10.4.3 (Submission Requirements for Rules Enforcement Proceedings initiated by the National Association), Appendix Ten, NACHA Rules.
[9] Subpart 10.4.7 (Fines and Penalties), Appendix Ten, NACHA Rules.

  - multiple consumer complaints alleging fraud or deception related to the products or services that the Originator or Third Party Sender's Originators offer;

- whether the Originator has or Third Party Sender's Originators have been the cause of RDFI claims of Rules violations or multiple RDFI complaints;

- whether the Originator or Third Party Sender's Originators are engaged in:

  - "high-risk" activities as identified by FFIEC agencies from time to time; or

  - activities, practices, or conduct that have been determined to be unfair or abusive by state or federal agencies;

- whether the Originator or Third Party Sender's Originators (or, as applicable, whether a Third Party Sender) has conducted a Rules compliance audit within the past year, the findings of the audit, and any remediation that resulted from the audit;

- the length of time the Originator or Third Party Sender's Originators have been in business; and

- the Originator's or Third Party Sender's Originators'

  - practices regarding communications with Receivers whose payments are returned and

  - controls for preventing ongoing origination of debits to Receivers that appear (based upon repeated returns) to be unable or unwilling to pay amounts owed (or purported to be owed) to the Originator.

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Thank you for the opportunity to provide further comments on the Proposal. If you have any questions or wish to discuss this matters referenced in this letter, please do not hesitate to contact me.

Very truly yours,

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