July 1, 2021

BY ELECTRONIC DELIVERY

Nacha
2550 Wasser Terrace, Suite 400
Herndon, VA 20171

Re: Nacha Request for Information on Risks of Early Funds Availability

To whom it may concern:

The Clearing House Payments Company L.L.C. ("The Clearing House")[1] respectfully submits this comment letter in response to Nacha's request for information on the risks of early funds availability ("RFI").

I. Executive Summary

The RFI seeks feedback on whether Nacha Rule changes are appropriate to modify the allocation of risk of loss where (i) an RDFI makes funds available from an ACH credit transfer prior to the settlement date, and (ii) an ODFI or Originator experiences a loss because it is unable to recover funds from the RDFI.[2]

Under the Nacha Operating Rules, an Originator uses the Effective Entry Date to specify the date interbank settlement of an ACH entry will occur. Nacha explains that the existing practice of RDFIs making funds available from an ACH credit prior to settlement creates risks on both the origination and receipt side. On the receipt side, the RDFI that provided early funds availability may not receive settlement and may not be able to recover the funds from the Receiver. On the origination side, the ODFI may be unable to recover funds from erroneous entries prior to settlement through a reversal (e.g., because the RDFI returns the reversal due to insufficient funds), or recover funds from a fraudulent transfer through a request for return.

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[1] Since its founding in 1853, The Clearing House has delivered safe and reliable payments systems, facilitated bank-led payments innovation, and provided thought leadership on strategic payments issues.

Today, The Clearing House is the only private-sector ACH and wire operator in the United States, clearing and settling nearly $2 trillion in U.S. dollar payments each day, representing half of all commercial ACH and wire volume. It continues to leverage its unique capabilities to support bank-led innovation, including launching the RTP® network, a real-time payment system that modernizes core payments capabilities for all U.S. financial institutions. As the country's oldest banking trade association, The Clearing House also provides informed advocacy and thought leadership on critical payments-related issues facing financial institutions today. The Clearing House is owned by 26 financial institutions (23 class AA and 3 class A) and supports hundreds of banks and credit unions through its core systems and related services.

[2] Nacha Request for Information on Risks of Early Funds Availability (May 21, 2021), https://www.nacha.org/rules/risks-early-funds-availability.

Some of our member financial institutions support a potential rule change to allow ODFIs to recover from RDFIs in certain scenarios where the RDFI has provided its customer early access to funds from an ACH credit. At the same time, other members question whether such a rule change is necessary or any limited benefits a rule change would bring are justified in light of potential unintended consequences and bad optics for the ACH network.

Regardless of whether Nacha moves forward with a rulemaking proposal on this topic, we encourage Nacha to provide industry education regarding the risks and issues that providing early funds availability may raise for both ODFIs and RDFIs. This is particularly important as we expect the practice of RDFIs providing early funds availability to continue to expand as consumers increasingly demand faster payments and quick access to funds.

II. Discussion

The Clearing House's member financial institutions hold varying views on certain aspects of the RFI. We have summarized key feedback from our member institutions below, including on issues where our members hold different positions.

A. Early Funds Availability Generally

There is a consensus among our member institutions that it is a valid business practice for RDFIs to accept the settlement risk and make funds from an ACH credit available to Receivers prior to the settlement date. As the RFI indicates, historically some institutions have done this due to system limitations that prevented warehousing of the ACH credits they receive until the settlement date. More recently, some institutions have offered early access to funds as a way to differentiate themselves in the market and compete for customers seeking access to funds one or two days prior to "payday." We expect the practice of providing early access to funds from ACH credits will become increasingly common as financial institutions strive to meet customer needs and market demands.[3]

The disparity between RDFIs that provide access to funds on the settlement date and those RDFIs (and Fintech providers) that make funds available early, was brought to the forefront by the recent Economic Impact Payments originated by the Treasury Department, and exacerbated by the special rules that apply to the Federal Government's use of the ACH network. We note, however, that those regulations and the Treasury Department's practice of originating ACH credits five banking days prior to settlement,

[3] While the RFI focuses on RDFIs that provide early funds availability, a number of Fintech providers offer products to their customers allow early access to funds, even though the RDFI itself is not providing early funds availability to the Fintech provider.

rather than the maximum of two banking days permitted for other ACH Originators, are not the focus of the RFI.[4]

B. Risks to ODFIs

The Clearing House believes that instances in which an RDFI provides funds availability prior to the settlement date and the ODFI or Originator suffers a loss as a result, are relatively rare. ODFIs or their Originators may suffer such losses from time to time. However, we do not believe this is currently a significant industry issue.

C. Need for a Rules Proposal

Some of our member institutions support a rule change to re-allocate liability from an ODFI to an RDFI for a loss where the RDFI provided early funds availability. This is primarily based on the view that the Originator should be able to recover funds, where permitted under the Nacha Rules, up to the date until the Originator intends a transaction to settle. For example, if an Originator originates a duplicate ACH entry on a Wednesday, which includes an Effective Entry Date of Friday, the Originator should be able to successfully reverse the duplicate entry if it originates the reversal on Wednesday or Thursday before the duplicate transaction settles on Friday.

Other member institutions do not support a rule change for a number of reasons. These institutions felt that the Originator should bear the risk of loss in the scenarios Nacha highlights in the RFI, regardless of whether the RDFI provides early funds availability, because the Originator is in the best position to prevent the loss. For example, some take the view that the core reason for an Originator's loss when it originates a duplicate ACH entry and a reversal is returned, is not the return of the reversal but the fact that the Originator initiated a duplicate in the first place. Further, whenever an Originator or ODFI initiates an erroneous entry, there is the potential that it will not be able to reverse that entry for various reasons regardless of whether the RDFI provides early funds availability (e.g., the Receiver's account is overdrawn, the RDFI exercises its setoff rights against funds from the incoming credit, or the account has a debit block). With this in mind, we have heard objections to treating returns of reversals where an RDFI provided early funds availability differently from returns of reversals that occur for other reasons.

In addition to returns of reversals, the RFI highlights the scenario of an ODFI that is unable to recover for an unauthorized credit entry where the ODFI requests a return under the Nacha Operating

[4] Under the Nacha Rules, the Effective Entry Date of an ACH credit may be no more than two banking days prior to the date of processing. *See* definition of "Effective Entry Date," Nacha Operating Rules, OR 123 (Appendix Three). However, the Treasury Department has exempted itself from this requirement. 31 C.F.R. 210.2(d). This exemption significantly increased the timing difference between RDFIs (and Fintech providers) that provided early access to funds from Economic Impact Payments (originated on Fridays), and RDFIs that provided access on the settlement date (the following Wednesday).

Rules.[5] Some of our members have expressed concern that fraudsters that originate unauthorized credits could coordinate with Receivers to take advantage of early funds availability as the practice expands. However, shifting liability from the ODFI to the RDFI for an unauthorized ACH credit entry would conflict with the established principle that the financial institution best positioned to prevent the unauthorized transfer (i.e., by authenticating its customer in a credit push payment) should bear the loss. It would also be inconsistent with the existing indemnification an ODFI provides an RDFI when requesting a return under the Nacha Operating Rules.[6]

Notwithstanding the varying views of our members, The Clearing House encourages Nacha to proceed cautiously on this issue in order to prevent unintended consequences or negative optics for the ACH network that may outweigh the benefit of a rule change to re-allocate liability. There is some concern that a rule change could negatively impact the ability of depository institutions to offer early funds availability from ACH credits and to compete effectively with Fintech providers such as digital wallets and prepaid companies that do so. A rule change could also create an optics issue for the ACH network if it is perceived as discouraging innovation or slowing down funds availability to the consumers most in need of fast access to their funds.

D. Potential Approaches to Risk Re-Allocation

The Clearing House does not support a prohibition on early funds availability. Among our member institutions that favor a rule change to re-allocate liability in the scenarios the RFI highlights, there are differing views on the other two approaches to recovering funds from RDFIs that Nacha laid out in the RFI.

A prohibition on returning a reversal for insufficient funds (R01 or R09) if both the original ACH credit and the reversal are received before the settlement date is a potentially effective approach. However, to be viable we believe this option would require changes to the Nacha format and financial institutions' systems given that today a reversal entry is not automatically tied to the original erroneous entry it intends to reverse. Without such changes, RDFIs may face uncertainty as to which reversal entries may or may not be reversed.

Creating a right of recovery under the Nacha Rules that ODFIs could pursue outside of the ACH network is a workable option, to the extent the rule provides clear standards for ODFIs to establish they could have corrected an error or recovered funds had the RDFI not provided early funds availability. If Nacha moves forward with this option, we recommend that Nacha consider establishing an appropriate dollar threshold for this right of recovery.

[5] Nacha Operating Rules, OR 36, Subsection 2.12.2.

[6] Nacha Operating Rules, OR 36, Subsection 2.12.3. In addition, the time from when an ODFI identifies an unauthorized ACH credit and requests a return until the RDFI reviews the situation and decides whether or not to return the funds, may extend past the settlement date of the transaction. Thus, as a practical matter we question how frequently the RDFI's decision to not return funds upon request would be directly linked to whether it made funds available before the settlement date.

E. Industry Education

Given the increasing prevalence of early funds availability products and services, The Clearing House believes it is important for the industry to understand the applicable Nacha Rules and related risks of this practice. Regardless of whether Nacha moves forward with a rulemaking to re-allocate liability between ODFIs and RDFIs, we encourage Nacha to consider developing an industry white paper that addresses the legal, risk, and operational issues associated with early funds availability business models. Among other things, such a document could explain the risks associated with providing early funds availability on both sides of a transaction and the relevant Nacha Rules, and provide information about best practices to prevent the issues that give rise to a loss from occurring in the first place.

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Thank you for the opportunity to comment on the RFI. If you have any questions or wish to discuss The Clearing House's comments, please do not hesitate to contact me using the contact information provided below.

Sincerely,

/s/

Jason Carone
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The Clearing House
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