

INSIDE: Important ACH Rules Changes Effective September 18..... 1
 Complying with the New Return Percentages..... 1
 Commentary: ACH, Return Rates and the Case for Transparency..... 3
 Behind the ACH Risk & Quality Rules..... 4
 ACH Risk & Quality Rules Frequently Asked Questions..... 4

Important ACH Rules Changes Effective September 18

It seems like all we are hearing about in the ACH Network today is Same Day ACH; and while that *is* a significant *Rules* change that will be implemented in 2016, there are some *ACH Rules* changes scheduled for September 18, 2015 that will significantly impact corporate users.

This special edition of *Inside Origination* is focused on the ACH Network Risk & Quality Rules to assist corporate users of ACH debit entries in preparing for their new requirements under these *Rules* changes.

The Risk & Quality Rules are comprised of several components aimed at improving the overall quality of transactions flowing through the Network, by reducing the number of returned entries and the costs associated with handling such entries.


Effective September 18, the existing return rate threshold for unauthorized ACH debit entries will be reduced from 1.0% to 0.5%.

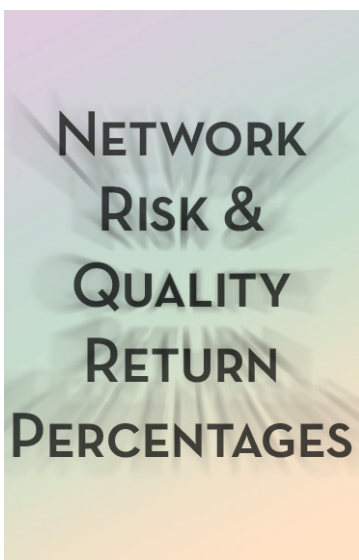
Ensuring compliance with this requirement may be as simple as ensuring you have obtained a proper authorization for every debit entry you initiate. The process for

handling over threshold activity remains the same, NACHA will notify your ODFI, who will in turn, notify you of the issue.

Two new return rate levels associated with administrative (bad account information) and overall return rates are also included in this rule. A level of 3.0% will apply to debit entries returned due to administrative or account data errors; an

overall level of 15% will apply to all debit entries returned (except for RCK entries) returned for any reason.

Additionally, the Risk & Quality Rules include clarification on reinitiation requirements and new formats for reinitiated entries. 



Complying with the New Return Percentages

Unauthorized Debit Returns

Since June 2010, NACHA has been tracking the return of unauthorized debit entries in an attempt to reduce return rates. Return reasons, including unauthorized and authorization revoked, are specifically being monitored to ensure that less than 1 percent of debit entries initiated by a company are returned for these reasons. This rule has proven to successfully reduce unauthorized return rates, which have leveled off at 0.3 percent. To ensure continued success in keeping unauthorized return rates low, this rule amendment will take effect on September 18th to further reduce the unauthorized return rate threshold to 0.5 percent.

So, what can your company do to ensure continued compliance with this lower requirement?

1. To minimize unauthorized returns associated with debit entries to a consumer account:
 - a. Ensure you obtain proper authorization before sending

see **PERCENTAGES** on page 2

the payment to your financial institution for processing. Authorizations must be identifiable as an authorization and contain clear and readily understandable terms. Authorization requirements are specific to the type of ACH debit being originated; therefore, if you are unsure that you are in compliance with these requirements, you should work with your financial institution to validate you are complying with these requirements.

- b. Send only payments that are due and owing from the consumer, ensuring the amount and debit date of the payments were agreed upon by the consumer.
 - c. Make sure the company name you have entered into your ACH file is recognized by the consumer. For example, if he/she knows your company as City Power & Light and not as CP&L, you'll need to spell out your company name in the ACH file instead of using your abbreviated name.
2. To minimize returns due to revoked authorizations by consumers:
- a. Include specific instructions within the authorization on how and when a consumer is to notify you of his/her intent to cancel future payments via ACH.
 - b. Ensure you have procedures in place to remove or delete the entry from your ACH file prior to sending the next payment after receiving such notification.
 - c. Have procedures in place to properly store revoked

authorizations for future documentation.

3. To minimize unauthorized returns associated with debit entries to a business account:
 - a. Ensure the payment terms and conditions for the purchase of goods or services are clearly outlined (e.g., in an agreement, invoice, etc.) and agreed upon.
 - b. Send only payments that are due and owing, ensuring those payments are for agreed upon amounts and debit dates.
 - c. Make sure the company name you have entered into your ACH file is recognized by your business client.

Debit Return Rate Levels for Administrative/Overall Returns

Debit entries returned for administrative reasons, such as account closed, invalid account number or unable to locate account, will also be tracked by NACHA beginning September 18th. A return rate level of 3.0 percent over 60 days will apply. Additionally, a return rate level of 15.0 percent will be applied to all debit entries, excluding RCK, regardless of the reason for return. While some level of returns may be unavoidable, excessive administrative and overall returns can be indicative of problematic Origination activities.

What can your company do to help avoid the return of debit entries due to erroneous or incorrect account information? You could start by sending a prenotification (prenote) entry; thus relying on the receiving financial institution to verify the routing and account information is correct. You may also choose to verify the account information provided is correct by requiring your customer/client to:

- Give you a voided check,
- Provide you with a letter from their financial institution including their routing and account number information, or

Compliance Checklist for Originators

- ✓ Review your ACH debit return rates for unauthorized, administrative and overall returns to ensure your rates are within the new percentages.
- ✓ Analyze returns data to gain a better understanding of how to ensure good transactions and fewer returns
- ✓ Review your authorization forms/practices – do they comply with the Rules for the types of transactions (i.e: PPD, WEB, TEL, etc.) you are utilizing?
- ✓ Ensure your ACH software is updated to enable the correct formatting of reinitiated entries
- ✓ Talk with your financial institution regarding actions you can take to ensure your ACH return rate percentages are under those prescribed in the *ACH Rules*
- ✓ Talk to your financial institution to fully understand any new fee structures that may exist in relation to this *Rules* change

- Manually enter routing and account number information twice, if captured via the Internet or a mobile app.

Reinitiation Practices More Clearly Defined

ACH payments, except RCK, may only be reinitiated if the original entry is returned:

- For insufficient funds,
- For stop payment and authorization to reinitiate has been obtained, or
- For administrative reasons and your company is able to correct the reason for return (e.g., if an entry is returned due to an invalid account number and you have new account information, you may reinitiate).

see PERCENTAGES on page 3



IMPACT OF NEW ACH RETURN RATES ON ORIGINATING COMPANIES

The return rate threshold for unauthorized entries will be reduced to .5 percent this September. New return rate levels for administrative and overall returns will also be implemented. How will these new rules impact your business? Learn how these changes, along with the enhanced rules for the reinitiating of return entries, are expected to strengthen the ACH Network and what they mean to your business' bottom line. Determine the difference between a threshold and a level, what to expect from your financial institution if your returns exceed a threshold or level, and steps to avoid a possible *Rules* violation or fine.

Date: Tuesday, August 25, 2015
Time: 10 am - 11 am CT

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PERCENTAGES continued from page 2

While these requirements will remain in effect, new formatting rules will be implemented September 18. These rules will explicitly require the contents of the Company Name, Company Identification and Amount fields to be identical to the contents of the original entry; and require reinitiated entries to be identified within the Company

Entry Description field as 'RETRY PYMT.'

If you haven't done so already, you'll want to contact your ACH software provider or financial institution to determine the necessary updates to ensure compliance with these formatting changes. You may also need to update your procedures related to the reinitiation of payments.

Commentary: ACH, Return Rates and the Case for Transparency

by Devon Marsh, Senior Vice President, Treasury Management & Internet Services, Risk & Compliance, Wells Fargo

Originators have begun thinking about the *ACH Rules* amendment on return rate levels that will become effective in September. Most Originators that look at their own return rates to see where they stand will see that their rates for unauthorized, administrative and overall returns fall below the percentages specified in the new rule. However a few will discover—or may already know—that their rates are higher than the rates NACHA has defined. These Originators must examine their debit origination activity closely and decide how to address their return rates.

The lowest rate in the new rule is actually the easiest one to achieve. In order to maintain a return rate for unauthorized transactions below 0.5 percent, an Originator must obtain a proper authorization for every debit entry. The other return rate categories—administrative and overall debit returns—have multiple causes and therefore multiple remedies. That's why each of these is defined as a return rate level rather than a hard-and-fast threshold. Nevertheless, an Originator must strive to achieve these levels, and be prepared to present a rational case for exceeding the level in the event of an inquiry and review.

The possibility of an inquiry should not intimidate an Originator or an ODFI. An

Originator with an overall debit return rate of greater than 15 percent should not shift its collection method to an instrument such as remotely created checks to avoid exceeding the ACH return rate level. A high ACH return rate raises a flag that is readily visible in a way that a high return rate for remotely created checks is not. A high return rate is not desirable, but a convenient flag is. ACH provides a practical way for an Originator to demonstrate the legitimacy of its collection activity even when its rate exceeds the desired level. Instead of shifting to Remotely Created Checks in response to a high overall return rate, the best course of action for an Originator is to show that it maintains the lowest administrative and overall return rates it can achieve in light of its business model and choice of collection method, that its rates do not result from negligence or complacency, and that they do not result from other rule violations such as excessive reinitiation.

A critical component of the origination of entries that stand a high risk of return is transparency of origination practices. At a time of increasing variety in payment methods, the legitimacy of financial transactions and the business practices that create them are of real concern. An Originator must be able to provide a clear view to its transactions, their underlying sources, and the business practices behind them. Proper use of the ACH Network affords this kind of transparency.

Behind the ACH Risk & Quality Rules

A chief purpose of the *Rules* is to provide new avenues for banks and NACHA to identify and act against so-called outliers, or originating businesses that generate returns out of proportion to the volume they handle, says Janet O. Estep, NACHA's president and chief executive. The *Rules* "do provide for more scrutiny of outliers that are causing more concern than not," she told *Digital Transactions News* shortly after the *Rules* proposal was released.

At the same time, NACHA is trying to balance its members' stakes in sometimes conflicting interests, including risk, innovation, and network quality, Estep says. "No one thing will fix all," she notes. "But if we are focused on the outliers, it's a more effective way to look at how to best address risk in the Network."

Some of the concern about outliers stems from recent ACH Network trends. After years of decline, the overall average network return rate for unauthorized transactions held steady in 2013 at 0.03 percent, the same as in 2012. While this represents just 3 out of every 10,000 transactions, the combination of increasing network volume and the bottoming out of the return rate means the absolute number of unauthorized transactions is up, along with the overall costs borne by receiving financial institutions.

The Network Risk and Enforcement Rule consists of four parts and aims at returns stemming from various causes, including unauthorized transactions as well as transactions returned for data errors. The actual return rate for data errors in 2013 was 0.33 percent, and the rate for returns of all reasons was 1.42 percent, according to NACHA. Other parts of the rule restrict the re-submission of returned entries.

The ACH Network Quality Rule seeks to raise costs to originating banks and at least partially reimburse receiving banks when unauthorized transactions occur. Under the rule, originating banks will be required to pay a fee to receiving banks for each debit returned as unauthorized.


The new fee for unauthorized returns is unrelated to the returns thresholds set in the Risk and Enforcement Rule and is simply based on the sheer number of unauthorized

transactions generated by the originating bank. The actual fee has not yet been set.

Estep says the fee will be linked to the costs receiving institutions incur for returned items, including the impact on customer service, but "by no means is it meant to be full cost recovery," she says.

Originating depository financial institutions, or ODFIs, act on behalf of businesses receiving payment *via ACH*, while most financial institutions fill the role of receiving depository financial institutions, or RDFIs, which hold the payor accounts.

Expert observers say that while transaction-return rates remain low for the ACH, at least some receiving institutions may be growing impatient with rising handling costs imposed by returned items.

"My read on these two new rules is that NACHA is responding to ... RDFIs who are experiencing increased costs to handle repetitive errors and returns," says Nancy Atkinson, a senior analyst for Boston-based consultancy Aite Group LLC, in an email message. "Those RDFIs want NACHA to assist them in dealing with ... ODFIs. [Unauthorized ACH returns] that are repetitive and can increase processing costs fairly substantially for RDFIs." 

Sources: John Steward, *Digital Transactions*



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