

# NACHA – The Electronic Payments Association

## Rule Making Process

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### **REQUEST FOR COMMENT RULES WORK GROUP #52 - OPERATIONAL EFFECIENCY ISSUES**

This Request For Comment (RFC) is being sent to ACH participants to obtain their comments on several operational efficiency issues. This RFC is comprised of the following parts:

- I. An Executive Summary,
- II. The Proposal,
- III. Draft Modifications to the *NACHA Operating Rules*, and
- IV. An ACH Participant Survey.

ACH participants are encouraged to comment on the proposal by completing the attached ACH Participant Survey. This RFC is being distributed for a comment period ending Wednesday, June 22, 2005. Comments should be sent to the attention of Maribel Bondoc, Manager of Network Rules, NACHA, 13665 Dulles Technology Drive, Suite 300, Herndon, VA 20171, fax: (703) 787-0996, E-mail: mbondoc@nacha.org. Questions should be directed to Deborah Shaw, AAP, Senior Director of Network Rules & Compliance, Cari Conahan, AAP, Director of Network Rules, or Debbie Barr, AAP, Director of Network Rules, at (703) 561-1100.

#### **I. EXECUTIVE SUMMARY**

This proposal includes thirteen changes to the *NACHA Operating Rules (Rules)* to modify aspects of ACH applications to function more efficiently in today's marketplace and to address inconsistencies within the *Rules*. This proposal would amend the *Rules* as follows to:

##### Identifying Companies

- 1) require that for corporate Originators the Company Identification Field must contain either the Originator's IRS Taxpayer Identification Number (TIN) for U.S. companies or, for non-U.S. companies, an identifier as described in 31 C.F.R. Part 103 which implements Section 326 of the USA PATRIOT Act, and
- 2) clarify the requirements for information included within the Company Name Field for Accounts Receivable (ARC) Entries,

### Unsecured Electronic Network

- 3) add to the ODFI requirement to verify the identity of a Third-Party Sender that uses an Unsecured Electronic Network and the corresponding audit requirement,
- 4) remove the reference to the Originator's obligations with respect to the use of secure Internet sessions for Internet-Initiated (WEB) Entries as it is more broadly covered within the section regarding the use of data security related to any banking information exchanged over an Unsecured Electronic Network such as the Internet,

### TEL Liability

- 5) add a new subsection to the requirements for Telephone-Initiated (TEL) Entries to specifically address the liability for breach of warranty for TEL entries to be consistent with other liability provisions,

### Return Code Issues

- 6) include Return Reason Code R05 (Unauthorized Debit to Consumer Account Using Corporate SEC Code) in the audit requirements,
- 7) modify the definition of Return Reason Code R16 (Account Frozen) to clarify that this return reason code may be used for the return of both debit and credit entries,

### Definitions

- 8) add the definition of Automated Accounting Advice (ADV) to Article Fourteen,
- 9) add the definition of Notification of Change (NOC) and the Standard Entry Class Code COR to Article Fourteen,

### ACH Operator Issues

- 10) clarify the parties with whom ACH Operator monthly return information may be shared to provide additional legal coverage for the ACH Operators when providing this information to NACHA,
- 11) modify ACH Operator Return Reason Code R27 (Trace Number Error) to reflect the current practice in which the Operators edit to ensure that the original entry trace number is included in the addenda record of an NOC entry,
- 12) modify ACH Operator Return Reason Code R36 (Return of Improper Credit Entry) to include XCK entries that are returned by the ACH Operator when those entries bear a credit transaction code,

13) clarify that certain fields and descriptive statements within ACH record formats must be transmitted using uppercase characters.

This Executive Summary is organized as follows: (1) background on the proposal, (2) an overview of the problem, and (3) a description of the proposal.

## **A. BACKGROUND**

Rules Work Group #52 addresses operational efficiency issues within the ACH Network to resolve inconsistencies or make minor improvements to the *Rules*. When an area for improvement to the Network is identified by an ACH participant, the Rules & Operations Committee determines whether it is appropriate for this Rules Work Group. This Rules Work Group is charged with the task of evaluating such issues and, when appropriate, recommending modifications to the *Rules*.

## **B. PROBLEM**

Most of the changes included in this proposal are the result of suggestions submitted by the Regional Payments Associations and ACH Operators to clarify the provisions of the *Rules*, thereby helping to ensure compliance by ACH participants. In addition, the proposals listed as “ACH Operator Issues” relate to software edit criteria that the ACH Operators have requested be reviewed and clarified. Lastly, three changes, included under the category Unsecured Electronic Network and related to Return Code R05 proposed within this RFC are clarifications due to either minor omissions or overlapping rules development processes.

## **C. PROPOSAL DESCRIPTION**

This RFC includes the following proposals to amend the *Rules*:

### Identifying Companies

- 1) This proposal would require that for all corporate Originators the Company Identification Field contain the Originator’s IRS Taxpayer Identification Number (TIN) for U.S. companies or, for non-U.S. companies, an identifier as outlined in 31 CFR Part 103 which implements section 326 of the USA PATRIOT Act so the Originator can be identified distinctly at a national level (see page 5).
- 2) This proposal would modify the *Rules* to clarify the requirements for information included within the Company Name Field for ARC entries within Appendix Two, Section 2.3 Glossary of File Format Data Elements to help ensure that Originators include the appropriate company name on ARC entries and to allow for greater automation (see page 6).

### Unsecured Electronic Network

- 3) This proposal would add to Article Two, Section 2.2.1.7, Verification of Identity of Originator, and the corresponding audit requirement in Appendix Eight, Section 8.3(I), to require ODFIs to use commercially reasonable methods to establish the identity of any Third-Party Sender that uses an Unsecured Electronic Network to enter into a contractual relationship with the ODFI for ACH origination to correct an oversight (see page 8).
- 4) This proposal would remove the Originator obligation for security of an internet session for WEB entries from Article Three, Section 3.9.4, as it is covered more broadly within another Originator obligation section, Article Three, Section 3.3, Transmission of ACH Information Via Unsecured Electronic Networks (see page 9).

#### TEL Liability

- 5) This proposal would add a new subsection (Article Two, Subsection 2.11.2.3) to the requirements for TEL entries to specifically address the liability for breach of warranty for TEL entries to be consistent with other similar liability sections (see page 10).

#### Return Code Issues

- 6) This proposal would include Return Reason Code R05 (Unauthorized Debit to Consumer Account Using Corporate SEC Code) in Appendix Eight, Subsections 8.2(J) and 8.3(J3) of the audit requirements to ensure that DFIs are verifying correct use of this code when conducting an audit (page 11).
- 7) This proposal would modify the definition of Return Reason Code R16 (Account Frozen) within Appendix Five to clarify that this return reason code may be used for the return of both debit and credit entries (page 12).

#### Definitions

- 8) This proposal would add the definition of Automated Accounting Device (ADV) to Article Fourteen (page 13).
- 9) This proposal would add the definition of Notification of Change (NOC) and the Standard Entry Class Code COR to Article Fourteen (page 14).

#### ACH Operator Issues

- 10) This proposal would clarify in Article Nine, Section 9.10 the parties with whom ACH Operator monthly return information may be shared to provide additional legal coverage for the ACH Operators when providing this information to NACHA (page 15).

- 11) This proposal would modify ACH Operator Return Reason Code R27 (Trace Number Error) within Appendix Three to reflect the current practice in which the Operators edit to ensure that the original entry trace number is included in the addenda record of an NOC entry (page 16).
- 12) This proposal would modify ACH Operator Return Reason Code R36 (Return of Improper Credit Entry) within Appendix Three to include XCK entries that are returned by the ACH Operator when those entries bear a credit transaction code (page 16).
- 13) This proposal would clarify within the Technical Appendixes that specific fields and descriptive statements within ACH record formats must be transmitted using uppercase characters (page 18).

These amendments have proposed implementation dates of either December 16, 2005 or March 17, 2006 (see page 20).

## **II. THE PROPOSAL**

This section of the RFC is comprised of the following components for each proposed rule amendment: (1) Business Objective; (2) Current Rules; (3) Current Marketplace/The Problem; (4) Proposed Rule Amendment and Other Options Considered; (5) Economic, Financial, and Impact Analysis; and (6) Operational Risk Assessment. Following the Summaries of Proposed Amendments for the thirteen proposed changes are general sections addressing B) the Change Readiness Assessment, C) Implementation Strategy, D) Communication and Education Plan, and E) Technical Summary.

### **A. SUMMARIES OF PROPOSED AMENDMENTS**

#### **1. Identifying Companies**

##### ***a. Requirements for Company Identification Field***

###### Business Objective

This proposed rule amendment would provide a means to identify distinctly, on a nationwide level, corporate Originators of ACH transactions. As the ACH Network grows and evolves, it is essential to be able to identify Originators for communication and risk management purposes.

###### Current Rules

The Company Identification Field is an alphameric code contained within ACH transactions to identify the Originator of an ACH entry. The Company Identification Field in the Company/Batch Header Record and Control Record currently must contain either the Originator's IRS Employer Identification Number (EIN), Data Universal Numbering System (DUNS) number, or a user assigned number. The Company

Identification is typically prefaced with an ANSI one-digit code that is used to identify the classification (i.e., EIN, DUNS, user-assigned) of the Company Identification.

#### Current Marketplace/The Problem

Currently, the Originator or ODFI could include a user assigned number in this field, which may not be unique to a particular originating company. For example, the same user-assigned number may be in use by multiple ODFIs but belong to unrelated companies. This makes it impossible to uniquely identify a particular Originator within the ACH Network; it also presents challenges in monitoring companies who use more than one Company Identification Number, such as when the same company originates through multiple ODFIs. With the growth of the ACH Network, it is critical for risk management, compliance, and communication to have such identification available. In addition, the USA PATRIOT Act has a similar requirement and this will aid in consistency.

#### Proposed Rule Amendment

This proposal would require that for corporate Originators, this field would contain the Originator's IRS Taxpayer Identification Number (TIN) for U.S. companies or for non-U.S. companies an identifier as outlined in 31 CFR Part 103 which implements section 326 of the USA PATRIOT Act. This proposed change would not affect consumers when they are Originators. In addition, this requirement would eliminate an ODFIs ability to use this field for a user assigned number.

An implementation date of March 17, 2006 is proposed for this amendment.

#### Economic, Financial, and Impact Analysis

*RDFIs & ACH Operators:* RDFIs and ACH Operators would be able to uniquely identify and track corporate Originators that are transmitting ACH entries into the ACH Network.

*ODFIs:* ODFIs would need to ensure that the number in the Company Identification Field is the TIN or other required number of the Originator noted in the Company Name Field. This field should not include information on third-parties that are processing the ACH entry.

*Originators & Third-Party Service Providers:* These parties would need to include the TIN or other required number of the Originator of the ACH entry within the proper field.

#### Operational Risk Assessment

This proposal would uniquely identify Originators at a national level and, in particular, help in recognizing Originators who may originate under multiple company names.

#### ***b. Company Name Field for ARC Entries***

##### Business Objective

This proposal would clarify the field content requirements of the Company Name Field of ARC entries to help ensure that Originators include the appropriate company name on

ACH entries (i.e., the payee of the source document). This would allow for greater automation of ARC processing and identification of entries on consumer statements.

#### Current Rules

Currently the *Rules* require the Originator of an ARC Entry to populate the Company Name Field with the name of the payee, as it appears on the face of the source document.

#### Current Marketplace/The Problem

The specific wording related to the contents of the Company Name Field for ARC Entries could present a problem to Originators in cases where a consumer makes the check payable to an incorrect payee. This could occur, for example, when the merchant's name has changed due to merger or acquisition, but the consumer continues to make the check payable to the previous company's name. In such cases, the Originator must either alter its high-speed processing of entries to ensure that the Company Name reflects the specific payee of each check or program its software to include the actual Originator's name and run the risk that it may be out of compliance with the *Rules* because the Company Name on the entry does not match the payee written on the face of the check.

#### Proposed Rule Amendment

This proposal would modify the definition to allow the Company Name Field to contain the name of the Originator, which is the payee of the source document. This field could contain the payee name as shown on the consumer's statement or invoice. This change would eliminate the specific requirement that the Company Name reflect the payee name as it appears on the face of the check, allowing Originators the flexibility to include on the entry the name of the actual payee.

An implementation date of December 16, 2005 is proposed for this amendment.

#### Economic, Financial, and Impact Analysis

*ODFIs & RDFIs:* There should be no impact to DFIs. ODFIs would warrant that the Field is used appropriately by Originators.

*Originators:* Originators would be able to add more automation to the ARC entry process. Originators should be sure to include a company name that is easily recognized by the consumer to reduce customer services issues and possible returns.

*Third-Party Service Providers:* A Third-Party Service Provider acting on behalf of an ACH participant (i.e., Originator, ODFI, or RDFI) would need to look at the relevant impacts described above to assess whether and how it would be impacted.

#### Operational Risk Assessment

Currently, an Originator that includes information within the Company Name Field of an ARC entry that differs from that which was written on the source document is at risk of violating the *Rules*. This proposal would alleviate this risk for the Originator.

## **2. Unsecured Electronic Network**

**a. *Third-Party Senders in Article Two, Section 2.2.1.7 and Appendix Eight, Section 8.3(I)***

Business Objective

This proposal would provide consistency of coverage within the *Rules* by extending the ODFI's obligation to use commercially reasonable procedures to establish the identity of any Third-Party Sender that uses an Unsecured Electronic Network<sup>1</sup> to enter into a contractual relationship with the ODFI for the origination of ACH transactions. The *Rules* already require the use of such procedures by the ODFI with respect to an Originator establishing a contractual relationship with the ODFI in this manner. This proposed change would ensure uniform requirements for identifying all remote customers of the ODFI.

Current Rules

Article Two, Section 2.2.1.7 (Verification of Identity of Originator) addresses the need for an ODFI to employ a commercially reasonable method to establish the identity of each Originator that uses an Unsecured Electronic Network to enter into the contractual relationship with the ODFI for the origination of ACH transactions. Appendix Eight, Section 8.3 (I) is the corresponding audit requirement for this *Rule*. In addition, Article Five, Obligations of Third-Party Senders, Section 5.3, Assumption of ODFI Warranties, places the assumption of this same warranty on any Third-Party Sender contracting with an Originator via an Unsecured Electronic Network.

Current Marketplace/The Problem

Under the *Rules*, a Third-Party Sender is required to enter into a contractual agreement with the ODFI when the Originator and the ODFI do not have an agreement directly between them for ACH origination services. Under the ODFI/Third-Party Sender agreement, the Third-Party Sender assumes specific obligations and liabilities generally assumed by the Originator. Although an ODFI is required to use commercially reasonable methods to establish the identity of each Originator when the Originator enters into the relationship with the ODFI via an Unsecured Electronic Network, no similar requirements exist when a Third-Party Sender enters into a contractual relationship remotely with an ODFI. The inability of the ODFI or Third-Party Sender to ensure that it adequately knows its customer poses a risk to the ODFI and, ultimately, the ACH Network as a whole.

Proposed Rule Amendment

This proposal would expand the current requirement that an ODFI employ commercially reasonable methods to establish the identity of each Originator that uses an Unsecured Electronic Network to enter into a contractual relationship with the ODFI for the origination of ACH transactions to include Third-Party Senders establishing contractual

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<sup>1</sup> An Unsecured Electronic Network is defined as a public or private network that is not located entirely within a single, contiguous, physical facility and any part of which that has not implemented security technologies that provide a level of security that, at a minimum, is equivalent to 128-bit RC4 encryption technology. Transmissions or exchanges of banking information over an Unsecured Electronic Network by means of voice or keypad inputs from a wireless telephone are not subject to this definition unless the telephone is used to access the Internet.

relationships with the ODFI in this manner. This proposal also includes corresponding modifications to the audit requirements contained with Appendix Eight, Section 8.3(I).

An implementation date of December 16, 2005 is proposed for this amendment.

#### Economic, Financial, and Impact Analysis

*ODFIs:* ODFIs would need to apply to Third-Party Senders the same level of identification that is used for Originators that use an Unsecured Electronic Network to enter into the contractual relationship with the ODFI for the origination of ACH transactions.

*RDFIs/ACH Operators/Originators:* There should be no impact to these parties from this proposed change.

*Third-Party Senders:* Third-Party Service Providers that are Third-Party Senders must employ a commercially reasonable method to establish the identity of each Originator that uses an Unsecured Electronic Network to enter into the contractual relationship with the Third-Party Sender for the origination of ACH transactions.

#### Operational Risk Assessment

The lack of a requirement for the ODFI to verify the identity of each Third-Party Sender that enters into a contractual relationship with the ODFI via an Unsecured Electronic Network imposes significant risk on the ODFI, which cannot ensure that it knows its customer, and ultimately imposes significant risk to the ACH Network overall. The inclusion of this requirement within the *Rules* would help to reduce risk in the Network.

#### ***b. Originator Obligation Related to Security of Internet Session for WEB Entries***

##### Business Objective

The objective of this proposal is to eliminate a redundant clause within the *Rules*.

##### Current Rules

When the rules for WEB entries were initially developed, they included a specific Originator obligation related to the use of a secure session for the exchange of any banking information over the Internet. As the ACH Network evolved, and more ACH information was exchanged via the Internet and other electronic networks, it became apparent that this requirement should be expanded to cover all ACH entries that involve the transmission or exchange of all banking information via unsecured electronic networks, regardless of which SEC Code would apply to the entry.

In September 2004, the *Rules* were amended to include a new section, Article Three, Section 3.3 (Transmission of ACH Information Via Unsecured Electronic Networks) to specifically require Originators to employ the use of 128-bit RC4 encryption technology for all ACH entries, regardless of SEC Code, for which any banking information is transmitted or exchanged via unsecured electronic networks. Because this new Originator obligation applies to all ACH transactions involving unsecured networks such as the

Internet, it is redundant to maintain similarly-worded language within the *Rules* related to WEB entries.

#### Current Marketplace/The Problem

The addition of language within Section 3.3 broadly requiring Originators to utilize a minimum specific level of encryption technology for all ACH entries involving the transmission or exchange of banking information over an unsecured electronic network such as the Internet makes subsection 3.9.4 (Security of Internet Session with respect to WEB entries) redundant and also is outdated as new Section 3.3. includes modifications to the level of encryption required as a result of advancements in encryption technology.

#### Proposed Rule Amendment

This proposal would amend the *Rules* to remove Article Three, Section 3.9.4, the Originator Obligation for data security related to WEB entries, as it is covered more broadly and accurately within Article Three, Section 3.3, Transmission of ACH Information Via Unsecured Electronic Networks.

An implementation date of December 16, 2005 is proposed for this amendment.

#### Economic, Financial, and Impact Analysis

This proposal should have no impact to ACH participants, as an Originator's data security obligations are covered elsewhere within the *Rules*. This proposal merely removes a redundancy within the *Rules*.

#### Operational Risk Assessment

This proposal should have a neutral impact on ACH risk. This proposal is merely the removal of redundant language and would not affect any risks associated with ACH entries involving the exchange of banking information via unsecured electronic networks.

### **3. TEL Liability**

#### ***Liability for Breach of Warranty for TEL Entries***

##### Business Objective

The objective of the proposal is to provide consistency of coverage within the *Rules*.

##### Current Rules

Article Two includes specific sections within the *Rules* that address processing requirements and warranties that are unique to certain SEC Codes (i.e., TEL, WEB, ARC, RCK, etc.) With the exception of TEL entries, each of these sections also contains specific language addressing an ODFI's liabilities for breach of these warranties.

##### Current Marketplace/The Problem

Although breaches of warranty for TEL entries are covered by the general warranties of an ODFI (Section 2.2 – Warranties and Liabilities of ODFIs), the inclusion of language

with respect to an ODFI's liability for breach of specific TEL warranties within the *Rules* addressing TEL entries would serve to ensure that ODFIs understand their obligations and potential liability related specifically to TEL entries. It would also help to ensure consistency of coverage within the *Rules*.

#### Proposed Rule Amendment

This proposal would add a new Article Two, Subsection 2.11.2.3 to address the liability for breach of warranty for TEL entries.

An implementation date of December 16, 2005 is proposed for this amendment.

#### Economic, Financial, and Impact Analysis

This proposal would have no impact on ACH participants. This modification is the clarification of an existing ODFI liability.

#### Operational Risk Assessment

This proposal should bring attention to the liability for breach of warranty for TEL entries and, in doing so, may reduce some risk in the ACH Network.

### **4. Return Code Issues**

#### ***a. Audit Requirements Related to Return Reason Code R05 (Unauthorized Debit to Consumer Account Using Corporate SEC Code)***

#### Business Objective

The objective of this proposal is to ensure that DFIs verify correct use of this return reason code when conducting an audit.

#### Current Rules

The *Rules* require an RDFI to obtain a Written Statement Under Penalty of Perjury (WSUPP) prior to returning an entry using the Return Reason Code R05. The *Rules* also prohibit an ODFI from reinitiating a returned entry unless (1) the entry has been returned for insufficient or uncollected funds; (2) the entry has been returned for stopped payment and re-initiation has been authorized by the Receiver; or (3) the ODFI has taken corrective action to remedy the reason for the return.

The audit requirements for RDFIs specifically require the RDFI to review records and procedures to ensure that WSUPPs are obtained from consumers for various return reason codes that require a WSUPP be obtained. These audit requirements do not, however, currently address entries returned using Return Reason Code R05. The audit requirements for ODFIs require the ODFI to ensure that Originators and Third-Party Senders are in compliance with the requirement that entries returned as R07, R08, or R10 are not re-initiated unless subsequent authorization is obtained from the consumer. These audit requirements do not require ODFIs to ensure that entries returned using Return Reason Code R05 are not reinitiated without subsequent reauthorization by the consumer.

### Current Marketplace/The Problem

Proper usage of Return Reason Code R05 should be included in the annual audit for both RDFIs and ODFIs, but it is currently not specifically listed in those requirements.

### Proposed Rule Amendment

This rule amendment would include Return Reason Code R05 (Unauthorized Debit to Consumer Account Using Corporate SEC Code) in Appendix Eight, Subsections 8.2(J) and 8.3(J3) of the audit requirements.

An implementation date of December 16, 2005 is proposed for this amendment.

### Economic, Financial, and Impact Analysis

*ODFIs:* ODFIs would need to ensure, as part of their audit requirements, that Originators are informed of their obligations to ensure that entries returned using Return Reason Code R05 are not reinitiated without proper authorization and using the correct SEC Code on new entries.

*RDFIs:* RDFIs would need to verify, as part of their audit requirements, that entries are not being returned using R05 without obtaining a WSUPP from the consumer account holder.

*ACH Operators:* There should be no impact to the ACH Operators.

*Originators:* Originators should examine their practices regarding return entries to ensure that entries returned using R05 are not re-initiated without obtaining proper authorization and research to determine the correct SEC code.

*Third-Party Service Providers:* A Third-Party Service Provider acting on behalf of an ACH participant (i.e., Originator, ODFI, or RDFI) would need to look at the relevant impacts described above to assess whether and how it would be impacted.

### Operational Risk Assessment

This proposal should reduce risk as ODFIs and RDFIs would be required, as part of their audits, to examine entries returned using Return Reason Code R05 to ensure compliance with the *Rules* related to these returns.

### ***b. Definition of Return Reason Code R16 (Account Frozen)***

#### Business Objective

The objective of this proposal is to modify the definition of Return Reason Code R16 (Account Frozen) to clarify that this Code may be used to return both credit and debit entries.

#### Current Rules

The current wording of Return Reason Code R16 implies that its designated use is specific to debits ("The funds in the account are unavailable due to specific action taken by the RDFI or by legal action.")

### Current Marketplace/The Problem

There are cases in which a financial institution may have taken action to freeze an account in preparation for account closure or restriction and may wish to prevent ACH credits, as well as debits, from posting to the account.

### Proposed Rule Amendment and Other Options Considered

Return Reason Code R23, which enables a credit entry to be refused by the Receiver, can not be used to return credit entries unless the account holder instructed the RDFI to return the credit. By modifying the description of Return Reason Code R16 to "access to the account is restricted due to specific action taken by the RDFI or by legal action," it would be made clearer to RDFIs that Return Reason Code R16 may be used for both debits and credits in situations where the RDFI has taken action to freeze the assets in the account.

An implementation date of December 16, 2005 is proposed for this amendment.

### Economic, Financial, and Impact Analysis

*ODFIs/RDFIs:* This modification should have no impact on DFIs, other than to make clear that Return Reason Code R16 may be used to return both credit and debit entries.

*ACH Operators/Originators/Third-Party Service Providers:* There should be no impact to these parties because of this modification.

### Operational Risk Assessment

This proposal would have no risk impact on RDFIs. It would simply clarify that an existing Return Reason Code could be used to return credit entries that can not be posted to an account.

## **5. Definitions**

### *a. Definition of Automated Accounting Advice (ADV)*

#### Business Objective

The objective of the proposal is to include terms in the definitions section of the *Rules*.

#### Current Rules

Article Fourteen of the *Rules* provides definitions of most of the available Standard Entry Class (SEC) Codes. The SEC Code ADV for Automated Accounting Advices is not included within Article Fourteen. This SEC Code represents an optional service provided by the ACH Operators that identifies automated accounting advices of ACH accounting information in machine readable format to facilitate the automation of accounting information for DFIs.

### Current Marketplace/The Problem

By not including the definition of ADV within Article Fourteen, there is an inconsistency in the *Rules*.

Proposed Rule Amendment

This proposal would add the definition of Automated Accounting Advice (ADV) to Article Fourteen, Definition of Terms.

An implementation date of December 16, 2005 is proposed for this amendment.

Economic, Financial and Impact Analysis

There would be no impact to ACH participants as this change merely adds a definition to the *Rules*.

Operational Risk Assessment

There should be no risk associated with adding this definition to the Article Fourteen.

**b. *Definition of Notification of Change and SEC Code COR***

Business Objective

The objective of this proposal is to provide consistency within the *Rules*.

Current Rules

Article Fourteen of the *Rules* includes definitions of most of the available Standard Entry Class (SEC) Codes. The definition of Notification of Change and the SEC Code COR, which is used for Automated Notifications of Change or Refused Notifications of Change, are not included within Article Fourteen.

Current Marketplace/The Problem

By not including the definition of Notification of Change or the SEC Code COR within Article Fourteen, there is an inconsistency in the *Rules*.

Proposed Rule Amendment

This proposal would add the definition of Notification of Change and the SEC Code COR to Article Fourteen, Definition of Terms.

An implementation date of December 16, 2005 is proposed for this amendment.

Economic, Financial and Impact Analysis

There would be no impact to ACH participants as this change merely adds a definition to the *Rules*.

Operational Risk Assessment

There should be no risk associated with adding this definition to the Article Fourteen.

**6. ACH Operator Issues**

**a. *ACH Operator Monthly Return Information***

Business Objective

The objective of this proposal is to clarify within the *Rules* the parties with whom NACHA may share information obtained from ACH Operator monthly reports regarding ACH return data. This would provide additional legal coverage for the ACH Operators when providing this information to NACHA.

Current Rules

Article Nine, Section 9.10, Requirement to Provide Information to National Association, requires that each ACH Operator provide monthly reports to NACHA relating to return entry data.

Current Marketplace/The Problem

Legal counsel representing one ACH Operator has expressed concern that the ACH Operator may be exposed to potential liability if any of the information provided to NACHA is shared with certain parties.

Proposed Rule Amendment

This proposal would clarify in Article Nine, Section 9.10, Requirement to Provide Information to National Association, that NACHA would disclose this information only to the ODFI and RDFI that are parties to the return entries, and to other parties that are reasonable or necessary to conduct enforcement proceedings or to facilitate the operation or administration of the *Rules*.

An implementation date of December 16, 2005 is proposed for this amendment.

Economic, Financial, and Impact Analysis

*ODFIs/RDFIs*: DFIs would experience a greater sense of security about return information that is being provided by the ACH Operators to NACHA.

*ACH Operators*: The proposal would provide greater clarity within the legal framework with respect to the distribution of potentially sensitive return information provided to NACHA by the ACH Operators. The ACH Operators should experience a greater sense security that information will be shared only with the specific parties specifically defined under the *Rules*.

*Originators/Third-Party Service Providers*: Originators may experience a greater sense of security about returns information that is being provided by the ACH Operators to NACHA.

Operational Risk Assessment

This proposal would establish a provision within the legal framework under which ACH participants agree to share specific return information provided by the ACH Operators only with the Participating DFIs involved in the transaction. This would help to reduce

any concern that potentially sensitive return data would be distributed to other parties not directly related to the transaction.

***b. Return Reason Code R27 (Trace Number Error)***

Business Objectives

The objective of the proposal is to provide consistency within the ACH Operator edits contained in the *Rules*.

Current Rules and Enforcement Methods

Currently the ACH Operators will reject an entry if the Original Entry Trace Number is not present in the Addenda Record for a return.

Current Marketplace/The Problem

The ACH Operators have identified a portion of the ACH Operator edit criteria for Return Reason Code R27 (Trace Number Error) that requires modification, as it does not accurately reflect current ACH Operator practice. The Operators have requested that Notifications of Change be added to the definition of Return Reason Code R27 (Trace Number Error) to clarify that a Notification of Change entry would be rejected by the ACH Operator if the Original Entry Trace Number from the forward entry is not provided in the NOC. The Original Entry Trace Number field is a mandatory field in COR entries and is edited by the ACH Operators, but this edit is not currently listed as part of the edit criteria defined within Appendix Three under Return Reason Code 27.

Proposed Rule Amendment and Other Options Considered

This proposal would modify Appendix Three, Section 3.6, ACH Operator Return Reason Code R27 (Trace Number Error) to clarify current ACH Operator practice in which NOCs that do not contain the Original Entry Trace Number within the Addenda Record will be rejected by the ACH Operator.

An implementation date of March 17, 2006 is proposed for this amendment.

Economic, Financial, and Impact Analysis

This proposal would have no impact to ACH participants. This change would simply clarify the current ACH Operator practice.

Operational Risk Assessment

The proposal would have a neutral impact on ACH risk. This change would have no operational impact as it is a clarification of the *Rules* to reflect the current ACH Operator practice.

***c. Return Reason Code R36 (Return of Improper Credit Entry)***

Business Objectives

The objective of this proposal is to provide consistency among ACH Operator edits related to the return of improper credit entries.

### Current Rules and Enforcement Methods

Return Reason Code R36 defines specific edit criteria under which certain SEC codes are returned by the ACH Operator if such transactions bear a credit transaction code (with the exception of reversals). These edits are currently defined within the *Rules* for the following SEC Codes: ARC, POP, RCK, WEB, and TEL.

### Current Marketplace/The Problem

Recently, the ACH Operators identified a conflict where an XCK credit entry was rejected by one ACH Operator but passed the edits for the other. The ACH Operators have requested that the description of Return Reason Code R36 (Return of Improper Credit Entry) be modified to include reject criteria for all XCK credit entries that are not reversals to ensure consistent handling by the ACH Operators.

### Proposed Rule Amendment

This proposal would modify Appendix Three, Section 3.6, ACH Operator Return Reason Code R36 (Return of Improper Credit Entry) to include XCK entries with the ACH Operator edits to reject credit transactions that are not reversals.

An implementation date of March 17, 2006 is proposed for this amendment.

### Economic, Financial, and Impact Analysis

*ODFIs:* ODFIs' software systems could not permit the origination of XCK entries that bear a credit transaction code, unless that entry is a reversal to correct an erroneous XCK entry.

*RDFIs:* This proposed change would have no impact on RDFIs.

*ACH Operators:* ACH Operators would modify their edit requirements related to Return Reason Code R36 to ensure that the edit criteria for XCK credit entries are consistent, and that XCK credit transactions are returned by the ACH Operator if they do not contain the word "reversal."

*Originators:* Originators could not transmit XCK credit entries unless those entries are reversals to correct previously-initiated, erroneous XCK entries.

*Third-Party Service Providers:* A Third-Party Service Provider acting on behalf of an ACH participant (i.e., Originator, ODFI, or RDFI) would need to look at the relevant impacts described above to assess whether and how it would be impacted.

### Operational Risk Assessment

This proposal would ensure that consistent edits are in place related to improper credit entries.

#### *d. Case Definition for Certain Fields and Defined Descriptions*

### Business Objective

This proposal would serve to provide consistency with ACH Operator edits related to the case of characters in certain fields.

### Current Rules

The Technical Specifications of the *Rules* do not specifically require characters to be either upper or lower case.

### Current Marketplace/The Problem

The ACH Operators' software systems contain edit criteria for certain fields they have specifically programmed as requiring uppercase characters (i.e., SEC Code, certain descriptions within the Company Entry Description field, "R" for return reason code, and "C" for change code). The Operators have requested that it be clarified within the *Rules* that this information must be in uppercase characters.

### Proposed Rule Amendment

This proposal would clarify within Appendix One, Section 1.3 and Appendix Two, Section 2.3, that certain fields and defined descriptions must be uppercase only. These fields include Standard Entry Class Code, the R in the return reason code, and the C in the change code. The ACH Operators have also requested clarification within the *Rules* that the following defined descriptions in the Company Entry Description field would also be required to be in upper case characters: REVERSAL, RECLAIM, NONSETTLED, AUTOENROLL (for ENR entries), REDEPCHECK (for RCK entries), and NO CHECK (for XCK entries). In addition, the descriptor of CHECK DESTROYED in the Company name Field for XCK entries should be upper case only.

An implementation date of March 17, 2006 is proposed for this amendment.

### Economic, Financial, and Impact Analysis

*ODFIs/RDFIs:* DFIs could make software modifications to ensure that uppercase characters are used when required.

*ACH Operators:* This proposal would ensure that specific fields within ACH records contain upper case characters as required for processing by the ACH Operators.

*Originators:* Originators could need to make software modifications to ensure that uppercase characters are used when required.

*Third-Party Service Providers:* A Third-Party Service Provider acting on behalf of an ACH participant (i.e., Originator, ODFI, or RDFI) would need to look at the relevant impacts described above to assess whether and how it would be impacted.

### Operational Risk Assessment

This proposal would ensure proper formatting of ACH transactions for more efficient processing by ACH Operators.

## **B. CHANGE READINESS ASSESSMENT**

The responses to the ACH Participant Survey will help determine the ability for ACH participants to respond to the changes proposed in this RFC.

## **C. IMPLEMENTATION STRATEGY**

The comment period for this RFC will close on June 10, 2005. If the comments are supportive of the proposal or the comments suggest a revision to the proposal that is relatively simple, a ballot could be prepared and sent to the NACHA Voting Membership in July 2005. This would accommodate portions of the changes being implemented in December 2005, and those with software impacts being implemented in March 2006.

## **D. COMMUNICATION AND EDUCATION PLAN**

If this proposal were approved as a rule amendment, the Regional Payments Associations and NACHA would begin educational efforts related to the changes that would include teleseminars and training sessions. A supplement to the *NACHA Operating Rules* would be issued. The Federal Reserve districts would be encouraged to educate those financial institutions in their districts that are not members of a Regional Payments Association.

## **E. TECHNICAL SUMMARY**

The following changes to the technical language within the *Rules* are included in this proposal with a recommended implementation date of **December 16, 2005**:

- removing the Originator Obligation for data security related to WEB entries from Article Three, Section 3.9.4, Security of Internet Session,
- adding Third-Party Senders to Article Two, Section 2.2.1.7, Verification of Identity of Originator or Third-Party Sender, and Appendix Eight, Rule Compliance Audit Requirements, Section 8.3(I),
- adding a subsection to the requirements for TEL entries (Article Two, Subsection 2.11.2.3, Liability for Breach of Warranty) to address the liability for breach of warranty for TEL entries,
- adding the definitions of Automated Accounting Advice (ADV) and Notification of Change to Article Fourteen, Definitions of Terms,
- including Return Reason Code R05 (Unauthorized Debit to Consumer Account Using a Corporate SEC Code) in Appendix Eight, Rule Compliance Audit Requirements, Subsections 8.2 (J) and 8.3 (J3) of the audit requirements,
- clarifying the requirements in Appendix Two, Section 2.3, Glossary of File Format Data Elements, for information included within the Company Name Field for ARC entries,
- clarifying Article Nine, Section 9.10, Requirement to Provide Information to National Association to specifically identify the parties with whom ACH Operator monthly return information may be shared, and

- modifying, in Appendix Five, Section 5.4, Table of Return Reason Codes, the definition of Return Reason Code R16 (Account Frozen) to clarify its usage for both debit and credit entries.

The following changes to the technical language within the *Rules* are included in this proposal with a recommended implementation date of **March 17, 2006**:

- modifying, in Appendix Three, Section 3.6, Automatic Entry Detail Return Entry, ACH Operator Return Reason Code R27 (Trace Number Error) to include NOCs,
- modifying, in Appendix Three, Section 3.6, Automatic Entry Detail Return Entry, ACH Operator Return Reason Code R36 (Return of Improper Credit Entry) to address the rejection of XCK credit entries that are not reversals,
- modifying in Appendix Two, Section 2.3, Glossary of File Format Data Elements the field contents for the Company Identification Field, and
- clarifying, in Appendix One, Section 1.3, Data Specifications; Appendix Two, Section 2.3, Glossary of File Format Data Elements; Appendix Five, Return Entries; and Appendix Six, Notification of Change that certain fields and defined descriptions must be uppercase only, and modifying in Appendix Three, Section 3.5, Automatic Batch Rejection, and Section 3.6, Automatic Entry Detail Return Entry, ACH Operator Return Reason Code R25 (Addenda Error) to reject entries with lowercase characters in specified fields.

#### **PROPOSED IMPLEMENTATION DATES:**

##### Identifying Companies

Requirements for Company Identification Field	3/17/06
Company Name Field for ARC entries	12/16/05

##### Unsecured Electronic Network

Third-Party Senders	12/16/05
Originator Obligation Related to Security of Internet Session	12/16/05

##### TEL Liability

Liability for Breach of Warranty for TEL Entries	12/16/05
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##### Return Code Issues

Audit Requirements Related to Return Reason Code R05	12/16/05
Definition of Return Reason Code R16 (Account Frozen)	12/16/05

##### Definitions

Definition of Automated Accounting Advice	12/16/05
Definition of Notification of Change	12/16/05

##### ACH Operator Issues

ACH Operator Monthly Return Information	12/16/05
Return Reason Code R27 (Trace Number Error)	3/17/06

Return Reason Code R36 (Return of Improper Credit Entry)	3/17/06
Case Definition for Certain Fields and Defined Descriptions	3/17/06