

January 13, 2014

By email to mbondoc@nacha.org

Maribel Bondoc
NACHA-the Electronic Payment Association
13450 Sunrise Valley Drive, Suite 100
Herndon, VA 20171

Re: Comments on Operating Rules Amendments to Improve Network Quality

Dear Ms. Bondoc:

Thank you for the opportunity to comment on NACHA's proposed amendments to the NACHA Operating Rules. These comments are submitted by the National Consumer Law Center (on behalf of its low income clients), Americans for Financial Reform, Consumer Action, the Consumer Federation of America, Consumers Union, the National Association of Consumer Advocates, the National Consumers League, and U.S. PIRG.¹

Overview

NACHA has proposed to increase the scrutiny of electronic payments that are returned as unauthorized or for other reasons. NACHA also proposes to institute a system of fines for those who originate such payments in order to provide greater incentives to avoid return ("exceptions") and to help the banks that receive those payments to partially recover their costs in handling them.

We support these proposals to improve NACHA's ability to enforce the rules against Originators who are responsible for disproportionate levels of exceptions and to establish incentives for originating depository financial institutions (ODFIs) and their Originators to improve origination quality. We believe that the proposals will be a win-win for all legitimate parties involved: consumers, receiving depository financial institutions (RDFIs), ODFIs, Originators and Third-Party Senders. Our only concern is whether the proposal goes far enough. For example, we believe that even lower return thresholds and higher cost recovery are warranted.

The proposals are justified by large numbers of unauthorized, fraudulent and unlawful payments that continue to be processed through the ACH system. Though the existing return thresholds have helped, they have not done enough to stop problematic origination practices. Millions of unauthorized payments are processed each year and that amount is increasing.

The scenarios under which unauthorized payments can occur are endless. A scam operator may obtain an account number by telling the consumer that he has won a lottery or contest

¹ Organizational descriptions are included in the Attachment.

and his banking information is needed to deposit the prize. Some credit card finders/brokers use their service to discover the consumer's checking account number and then electronically take money out of that account. The same is the case with credit repair organizations and companies that promise, for a fee, to find the consumer unused scholarships and grants. Other scam operators ask for a checking account number to pay for specified services, but then withdraw funds from the consumer's account without authorization and without providing the promised services. A fraudulent company may obtain the consumer's authorization for one payment and use it to present new drafts month after month.

Consumers suffer when their accounts are debited improperly. Although Regulation E and NACHA rules give consumers protection against unauthorized charges, many consumers do not know how to assert their rights. Even when consumers are ultimately able to recover their funds, in the meantime they may struggle to pay bills and may incur bounced check fees, merchant return fees, and stop payment fees that are never reimbursed. The time to deal with an account that has been hijacked can also be tremendous. Misuse of the ACH system also makes consumers wary of electronic payments generally and reluctant to engage in electronic commerce.

RDFIs, which are on the front lines, bear the burden of dealing with angry consumers when their accounts are debited improperly. Even when the fault lies with unscrupulous Originators, the RDFI incurs strained customer relations, the expense of dealing with returns and handling calls and complaints, and a damaged reputation.

ODFIs that process payments that are ultimately returned also are at risk. They incur the expense of indemnifying the RDFI and handling the return. ODFIs risk enforcement action and litigation. Regulators have made clear that ODFIs have a responsibility to know their customers and their customers' customers. Regulators and courts may believe that warning signs should have led the ODFI to undertake greater due diligence to ensure that it was not processing improper payments. Some ODFIs may be tempted to take on higher risk customers in return for fee income. Smaller banks in particular may have less sophisticated due diligence operations or experience to warn them away from problematic customers. ODFIs of all sizes suffer reputation risk when they are involved, even if inadvertently, in payment scams.

Likewise, legitimate payment processors can find themselves caught in the middle if unscrupulous payments are submitted through the processors. Scammers and complicit processors are becoming more sophisticated and may move returns around, or submit payments through nested processors, to mask return rates and the ultimate payee. The payment processing industry as a whole is suffering increased regulatory scrutiny and reputation damage due to the actions of a few.

Finally, legitimate merchants and other Originators also suffer when the ACH system is used improperly. They lose business when consumers are unwilling to shop on the internet. They lose efficiencies when consumers insist on paying by check because they do not trust the electronic payment systems.

Consequently, consumers and all legitimate industry participants in the ACH system will benefit from rules that improve network quality, reduce returns, screen out illegitimate players, and impose costs on those who create them. The modest costs of the proposals are well worth the return for all concerned.

Comments on Specific Proposals

Lower return rate threshold for unauthorized debit

System wide, NACHA's latest data reveal an overall unauthorized debit return rate of 0.03 percent in calendar year 2012. While that number is low on a percentage basis, it represents millions of unauthorized debits. Those numbers are increasing as ACH volume increases, and the benefits from NACHA's prior reforms appear to have run their course.

Returns for authorization problems should never be at more than de minimis levels for a given Originator. Each unauthorized or disputed debit represents a significant problem for the Receiver and a point of friction and expense for the RDFI. Legitimate merchants and payment processors have no reason to incur more than a very rare unauthorized return.

We support a lower threshold for unauthorized returns, though are not sure if the proposal is the right threshold. NACHA proposes to reduce from 1.0 percent to 0.5 percent the return rate threshold for unauthorized debits (returns due to a problem with authorization, including unauthorized, revoked authorization, stopped payments or RDFI customer disputes). Even a reduced level of 0.5 percent is more than 16 times the average return rate, a level that we believe is still too high. Most Originators operate well below the 0.5 percent level, and that level still permits outliers. We believe that, at most, a 0.3 percent return rate – 10 times the average – would be appropriate.

Overall debit return rate

The proposal would establish a new overall debit return rate threshold of 15.0 percent.² We agree that it is important for ODFIs and Originators to monitor the overall debit return rate and not merely returns coded as unauthorized. All returns impose burdens on RDFIs. The RDFI must take time to deal with the return, determine the problem and address it. If the return impacts the consumer, the return will likely generate friction and additional customer service expenses.

Returns based on account closures may indicate that the merchant is buying account numbers in order to conduct identity theft, or that the consumer has been forced to close the account in

² We have no comment on the proposed return rate of 3.0 percent for account data issues.

order to address unauthorized debits. Legitimate merchants will only rarely initiate a debit against an account that turns out to be closed.

Returns for nonsufficient funds (NSF) may indicate underlying authorization problems or other origination practices, and impose further pain on consumers through NSF fees. NSF returns can also lead the RDFI to close the account, harming both the consumer who has lost a bank account and the RDFI which has lost a customer.

Modest NSF returns are inevitable, especially for businesses dealing with families who are struggling paycheck to paycheck. Some leeway for occasional NSF returns is appropriate in order to prevent merchants from refusing to accept ACH payments from these consumers.

But disproportionately high NSF returns are a sign of problematic origination practices. High returns can be a sign that consumers are not expecting the debits and did not arrange to have funds available, or that the account has been debited repeatedly without authorization. The payment may be unauthorized, be in a different amount or at a different time from what the consumer expected, or be based on purported authorization that was obtained through trickery or misleading practices.

High levels of NSF returns can also be a sign that the Third Party Sender is engaging in predatory practices aimed at vulnerable consumers. Aggressive and often unlawful efforts to collect from these customers add to the volume of NSF returns. Predatory practices not only harm consumers, but they also impose burdens on RDFIs, which have no control over those practices but have to deal with the consequences of the NSFs.

Notably, the ACH system is not the only way for consumers to make payments. If a business has a predominantly low income clientele who frequently lack the funds to cover a payment, then preauthorized ACH payments may not be the best way to pay. Consumers can pay by credit, debit or prepaid card, where authorization is immediate. Or the consumer can initiate an ACH payment through her RDFI, rather than preauthorizing the merchant to initiate an ACH debit. When the payment is initiated through the consumer's bank rather than through a preauthorization, the payment simply does not happen if the account lacks funds, so there are no returns. Consumers also have more ability to adjust and control the amount and timing of payments that they initiate through their own banks in order to prevent problems.

Putting a limit on overall ACH return rates will not prevent merchants from dealing with low income consumers. For entities such as utility companies that have a broad range of consumers, the few returns generated by taking preauthorizations from lower income consumers will not be a significant percentage of the company's overall ACH business. Merchants who deal with a more exclusively low income customer base can find a payment method that does not generate high returns for RDFIs to deal with.

The proposed 15.0 percent return threshold – ten times the average of 1.5 percent – seems unduly high. That is more than one in every seven payments. A business whose returns are that

high has a problem that needs to be addressed. A level of 10.0 percent returns seems more appropriate.

It is important to note that there are no immediate consequences for the mere fact of exceeding the overall return threshold. Neither the ODFI nor the Originator or Third-Party Sender will be immediately ejected from the ACH system or suffer an enforcement action. An ODFI that has an Originator or Third-Party Sender who exceeds the threshold must respond to a NACHA inquiry, provide additional reporting and a plan to NACHA, and actually bring the return rate below the applicable threshold within 30 days and maintain the threshold for 180 days. Those are appropriate actions when an Originator's returns exceed 10 or 15 percent.

Return thresholds for credit entries

The Request for Comment asks whether return rate thresholds should apply to credit Entries, in addition to the debit Entries to which the proposal currently applies. We believe that returns of credit Entries should be included in the return threshold. Indeed, perhaps credit Entry returns should have their own threshold in addition to being included in the overall return threshold.

As the Request for Comment indicates, problematic Originators sometimes use credit Entries to attempt to verify account information. Scammers who buy stolen account information may use credit Entries to screen out accounts that have been closed before initiating debit Entries. This practice is likely to increase in light of the scrutiny of returns of debit Entries, because it is a method of avoiding returns. If only debit Entries are monitored, then some scammers may evade detection by using credit Entries to screen out old accounts before pushing scam payments through.

High return rates for credit Entries are a strong sign that an Originator is engaged in problematic practices. Legitimate merchants do not have high volumes of incorrect account information. Any returns would be swamped by a significant volume of successful deposits. Similarly, legitimate merchants who use small credit Entries as a means of confirming the accuracy of information supplied by a consumer for future payments are also unlikely to have high returns. Monitoring returns of credit Entries would be very useful to flag problematic origination practices and to make sure that credit Entries are not being used to evade the debit return thresholds.

Establishing a separate threshold for credit Entries might make it easier to isolate and identify these problematic practices. An entity that is regularly initiating credit Entries, such as a payroll processor, will have very low levels of returned credit Entries. But a merchant that is primarily in the business of taking payments *from* consumers, using account information that regularly turns out to be inaccurate, will have return levels that stand out and should trigger scrutiny.

Clarification of permissible practices for collection of returned ACH debits

The proposal clarifies permissible and impermissible practices for the collection of ACH debits returned for insufficient funds and other reasons. The proposed rule codifies the interpretation of current rules that NACHA already put forth in its ACH Operations Bulletin 3-2013, “Reinitiation of Returned Debit Entries.” The proposal (1) limits permissible reinitiations to the circumstances permitted under the Rules; (2) adopts measures to prevent evasions; (3) exempts certain Entries from being considered a re-initiation; and (4) adopts labeling requirements. We strongly support proposals (1), (2) and (4), and generally support (3) though with some limitations.

Reinitiations of returned ACH debits are one of the worst pain points for both consumers and RDFIs. They cause multiple NSF fees imposed on consumers, frustrate efforts to deal with unauthorized payments, generate consumer anger at the RDFI, and can lead to bank account closures. The proposed Rules prevent misuse of the reinitiation process but do not prevent legitimate reinitiations.

The reinitiations currently permitted under the Rules are adequate to address legitimate purposes, and we support an explicit ban on reinitiations under circumstances not explicitly permitted under the Rules. The Rules permit two attempts to reinitiate an Entry returned for lack of funds: a reinitiation that corrects an error such as incorrect account number, and a reinitiation after a stop payment order, but only if the Receiver has subsequently re-authorized the reinitiation. Other reinitiations should be prohibited. One would have thought that an explicit ban on reinitiating a return coded as unauthorized would not be necessary, but it certainly makes sense to leave no doubt.

We also support the proposed measures to combat evasions. The consumers that our organizations serve have often seen evasive measures such as adding or subtracting a few cents to the payment amount, splitting a payment into multiple smaller payments, or a change in names in an effort to evade a stop payment order or a challenge to a prior payment as unauthorized. A general anti-evasion rule, as well as a listing of some examples of impermissible evasions, will help stop circumvention of the Rules.

We support the proposal to require that reinitiations be labeled as REDEPOSIT. The label will help both ODFIs and RDFIs identify reinitiations and to ensure that they are handled appropriately. The lack of such a label, and especially an Originator’s routine practice of omitting such labels, would be a Rule violation and a sign of evasion that may warrant enforcement action.

NACHA proposes to exclude a debit Entry in a series of preauthorized recurring debits Entries from being classified as a reinitiation. We agree that this is appropriate in the example that NACHA provides: the October payment of a credit card, following a September payment that was returned for insufficient funds. We also appreciate and support the caveat that the exemption does not apply to subsequent debit Entries that are contingent upon an earlier debit

being returned. For example, if a consumer disputes or stops payment of an obligation, any attempt to accelerate and collect the outstanding principal by ACH would be a reinitiation and would not be permitted under the Rules.

We are concerned, however, that the exemption for a series of preauthorized debits may be overbroad and should rather be limited to subsequent debit Entries following NSF returns alone. If a preauthorized debit has been returned as unauthorized, the Originator should not be permitted to initiate the next debit in the series. But by exempting such debits from the definition of reinitiation, the proposed rule would also exempt them from the ban on reinitiating a return coded as unauthorized.

We have similar concerns about exempting re-authorized debits from the definition of reinitiation. We appreciate the caveat that a renewed authorization may not be obtained in advance, but rather only after the first Entry was returned. We also agree that the limit of two reinitiations should not apply if the consumer subsequently deposits funds into an account and authorizes the Originator to debit the account one more time.

But the clock should not start completely over, permitting two more reinitiations of that debit. It should still be considered a reinitiation and should be labeled as such, permitted both the consumer and the RDFI to recognize that it is, indeed, a new attempt to initiate the original debit. Instead of exempting such debits from the definition of reinitiation, NACHA could adopt an exception to the limit on two reinitiations, permitting a third attempt if explicitly, subsequently authorized by the Receiver. Otherwise, a reauthorization – which may be questionable – would justify not just one more reinitiation (and potentially one more NSF fee for the consumer) but three.

Finally, we agree that it makes no sense to require the Receiver to complete a second Written Statement of Unauthorized Debit if there is a violation of the Reinitiation Rule. Such a requirement will only burden the RDFI and the consumer, interfere with their ability to protect the account, and cause more friction between the RDFI and the consumer. The consumer does not understand what requirements come from NACHA and what come from the bank. The consumer will be upset at needless paperwork and the RDFI will bear the consequences.

Third Party Senders

We support the proposal to clarify that Third-Party Senders who act on an ODFI's behalf to monitor, assess and enforce limitations on their customers' origination and return activities have the same obligations under the Rules as ODFIs. Entities who undertake compliance duties on behalf of an ODFI certainly must be subject to the same obligations.

We also agree that it would streamline NACHA's oversight role to allow NACHA to require from ODFIs, and to require ODFIs to provide, proof of the audits of Third-Party Service Providers and Third-Party Senders that are already required. This requirement will also help ODFIs to

remember and comply with their audit obligations and to avoid the problems that lack of audits can cause.

NACHA enforcement authority

We support providing NACHA express authority to initiate enforcement proceedings based on the origination of unauthorized entries. Although in most cases NACHA will likely follow the current procedures under the Rules before initiating an enforcement action, in compelling cases NACHA should not have to wait for specific claims to be asserted by participating DFIs before taking action.

We also ask that NACHA institute a routine practice of adding any Originator who has exceeded one of the return thresholds to the Originator Watch List.

ODFI fees paid to RDFI for exceptions

We support the proposal to require ODFIs to pay a fee to the RDFI when an ACH transaction is returned due to incorrect account data or a problem with the Receiver's authorization, or when the RDFI corrects information and sends the correction back to the ODFI. These problems are caused by problematic origination practices but the RDFIs bear the brunt of the costs to correct them.

The fees will provide modest but appropriate incentives to ODFIs to monitor the quality of the debits they process and to reduce the number of returns and exceptions. Improved processes and tools to do so will benefit the ODFI itself as well as the RDFI and consumers and other Receivers.

The fees will counteract some of the inappropriate incentives that lead some ODFIs to take on high risk originators without appropriate controls, resulting in harm to RDFIs and consumers and damage to the reputation of all DFIs and the payment system. High risk originators pay lucrative fees to ODFIs who look the other way when processing their payments. The Department of Justice's recent case against Four Oaks Bank illustrates how fee income can persuade an ODFI to neglect its obligation to avoid facilitating improper payments.³ The proposed fees will provide a modest counter balance. High return fees will also be another way that regulators can spot ODFIs who are not fulfilling their responsibilities to ensure the integrity of the payment system.

The proposed fees will also make it easier for RDFIs to provide appropriate customer service to Receivers and to waive stop payment fees, overdraft fees or NSF fees. Consumers should not bear any of these fees if an ACH debit is unauthorized, but RDFIs are sometimes reluctant to

³ See Complaint for Injunctive Relief and Civil Monetary Penalties, United States v. Four Oaks Fincorp, Inc., and Four Oaks Bank & Trust Company, (E.D. N.C. Jan. 8, 2014), available at <http://www.courthousenews.com/2014/01/09/USvFourOaks.pdf>.

waive them despite the unauthorized nature of the debit. Moreover, when the consumer is hit with a series of unauthorized debits, the only way to stop future debits may be to enter a stop payment order – triggering stop payment fees – even if the real problem is not that the consumer wants to stop a payment she authorized but rather that she cannot afford to let an unauthorized debit post and then contest it afterwards.

Indeed, the proposed fees appear too low, especially for unauthorized entries. The range of \$1.50 to \$2.50 is far below the \$35 a consumer will pay to stop payment on future unauthorized entries or in NSF or overdraft fees. It is a miniscule penalty compared to the harm of a much larger unauthorized debit. And it is below the RDFI's costs, especially for small RDFIs. As NACHA noted, the cost for an unauthorized exception to a small RDFI can be as high as \$509.09. Even that calculation does not include additional costs related to customer contact and service via branch, phone internet, or compliance costs for Regulation E dispute resolution. Higher fees for unauthorized returns will reinforce incentives to address the worst types of problems and will give RDFIs more leeway to waive fees for customers.

Conclusion

We thank NACHA and its members for their efforts to improve the quality of the ACH system. These efforts are vitally important, not only for the ACH system, but for public faith in the banking system overall. Consumers and banks alike are damaged by problematic ACH origination practices. The modest, carefully calibrated proposals are an important step forward in reducing returns, a goal that will benefit all legitimate players in the payment system.

Sincerely,

Lauren Saunders
National Consumer Law Center (on behalf of its low income clients)

Lisa Donner
Americans for Financial Reform

Jean Ann Fox
Consumer Federation of America

Ruth Susswein
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APPENDIX: Organizational Biographies

Since 1969, the nonprofit **National Consumer Law Center® (NCLC®)** has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness.

Americans for Financial Reform is an unprecedented coalition of over 250 national, state and local groups who have come together to reform the financial industry. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, faith based and business groups.

The **Consumer Federation of America** is an association of nearly 300 nonprofit consumer groups that was established in 1968 to advance the consumer interest through research, advocacy and education.

Consumer Action has been a champion of underrepresented consumers nationwide since 1971. A nonprofit 501(c)3 organization, Consumer Action focuses on financial education that empowers low to moderate income and limited-English-speaking consumers to financially prosper. It also advocates for consumers in the media and before lawmakers to advance consumer rights and promote industry-wide change.

By providing financial education materials in multiple languages, a free national hotline and regular financial product surveys, Consumer Action helps consumers assert their rights in the marketplace and make financially savvy choices. More than 8,000 community and grassroots organizations benefit annually from its extensive outreach programs, training materials, and support.

Consumers Union is the public policy and advocacy division of Consumer Reports. Consumers Union works for telecommunications reform, health reform, food and product safety, financial reform, and other consumer issues. Consumer Reports is the world's largest independent product-testing organization. Using its more than 50 labs, auto test center, and survey research center, the nonprofit rates thousands of products and services annually. Founded in 1936, Consumer Reports has over 8 million subscribers to its magazine, website, and other publications.

The **National Association of Consumer Advocates (NACA)** is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

National Consumer's League, founded in 1899, is the nation's pioneering consumer organization. Our non-profit mission is to protect and promote social and economic justice for consumers and workers in the United States and abroad.

U.S. Public Interest Research Group (U.S. PIRG) serves as the Federation of State PIRGs, which are non-profit, non-partisan public interest advocacy organizations that take on powerful interests on behalf of their members. For years, U.S. PIRG's consumer program has designated a fair financial marketplace as a priority. Our advocacy work has focused on issues including credit and debit cards, deposit accounts, payday lending and rent-to-own, credit reporting and credit scoring and opposition to preemption of strong state laws and enforcement. On the web at uspig.org.