ACH Message Entries:
Automating Exception Processing via ACH

NACHA Request for Comment
March 12, 2018
ACH Message Entries - Introduction

• NACHA invites comments on proposed rules to use the ACH Network for a new, ubiquitous capability to exchange non-monetary messages between financial institutions (referred to in a 2017 Request for Information as “DFI to DFI Messaging”)
• Currently, requests and responses for various types of ACH-related documents and other information related to ACH transactions are handled outside of the ACH Network via manual processes
• Today, NACHA is issuing this Request for Comment to generate feedback on the benefits and the impacts of this proposal. NACHA is accepting comments through Friday, April 27, 2018. NACHA encourages responses from all ACH Network participants and interested parties
• For more information about the proposed rules and how to submit comments, please visit www.nacha.org
Request For Comment Components

This Request for Comment consist of three components

- This summary presentation
- A survey
- Proposed modifications to the NACHA Operating Rules
ACH Message Entries: Automating Exception Processing via ACH

Request for Comment
Part 1 – Messaging Proposal and Use Cases
ACH Message Entries - Proposal at a Glance

• Financial Institutions would use new non-monetary ACH Message Entries with a new SEC Code of “MSG,” and supporting Addenda Records, as messages and responses to request and provide various types of information related to ACH transactions
  – Record of Authorization
  – Source Document (converted check) copy
  – Written Statement of Unauthorized Debit copy
  – ODFI-requested returns
  – Additional information related to an Originator
  – Trace Request
  – Other

• Financial institutions receiving these messages also would respond via Message Entries, also using the new MSG SEC Code and Addenda Records inclusive of information to tie the response to the original request

• Currently, these types of requests and responses occur outside the ACH Network, and are mostly manual with associated costs
ACH Message Entries - Proposal at a Glance

• The ACH Network currently supports several types of non-monetary messages
  – Prenotification – used to validate account information
  – Notification of Change – corrects routing and/or account information
  – Death Notification – allows a Federal government agency to notify an FI of the death of a beneficiary
  – Automated Enrollment – enrolls a beneficiary in a Federal government benefit program
• New non-monetary messages are similar in concept to these existing messages and the proposed formatting could lay the groundwork for other enhancements or innovative uses of messaging in the ACH Network
Concept Origin and RFI Results

• In 2017, NACHA issued a Request for Information (RFI) on the concept of “DFI to DFI Messaging”
  – Responses from the RFI indicated substantial support for the six use cases that were outlined
  – The Product Innovation Standing Rules Workgroup utilized the responses from the RFI to craft this Request for Comment and the business case information contained
• 69% of RFI respondents indicated that the use of DFI to DFI Messaging would reduce or eliminate costs and manual processes associated with making and responding to the identified types of requests
  – An additional 17% indicated that they required more proposal details to make the determination
Use Cases for ACH Message Entries

• Currently, the NACHA Operating Rules require that Financial Institutions respond to inquiries for copies of required records within ten Banking Days
  – Record of Authorization
  – Source Document/Converted Check Copy
  – Written Statement of Unauthorized Debit (WSUD)
Use Cases for ACH Message Entries

• In addition to sending and receiving copies of requests for documents required under the Rules, the ACH messaging framework would be used for other ACH-related functions
  – ODFI-Requested Returns
  – Requesting additional information related to an Originator
  – Trace Messages

• These six use cases are described in more detail on the following slides
Use Cases for ACH Message Entries

1. Record of Authorization
   - Under the *Rules*, an ODFI must provide an RDFI with a record of a Receiver’s authorization within 10 Banking Days of receiving a written request (Subsection 2.3.2.5(b) and Subsection 2.3.3.3(a))
     • The proposed rule change substitutes a Message Entry for the written request
   - Currently, an RDFI’s written request, and an ODFI’s provision of the record, take place manually outside the ACH Network
     • The proposed rule change requires the ODFI to respond via a Message Entry
     • The requested document could be uploaded into a trusted document repository that the RDFI would access
Use Cases for ACH Message Entries

2. Source Document/Converted Check

- Under the Rules, an ODFI must provide an RDFI with a copy of a Receiver’s Source Document (i.e., converted check) for an ARC or BOC entry (Subsections 2.5.1.5(d), 2.5.2.5 (i), respectively) or a copy of an item for an RCK (Subsection 2.5.13.5) within 10 Banking Days of receiving a written request
  • The proposed rule change substitutes a Message Entry for the written request
- Under the Rules, an ODFI must provide an RDFI with a copy of an item for an XCK (Subsection 2.5.18.4) within 30 days of receiving a written request
  • The proposed rule change substitutes a Message Entry for the written request
- Currently, an RDFI’s written request, and an ODFI’s provision of the record, take place manually outside the ACH Network
  • The proposed rule change requires an ODFI to respond via a Message Entry
  • The requested document could be uploaded into a trusted document repository that the RDFI would access
Use Cases for ACH Message Entries

3. Written Statement of Unauthorized Debit (WSUD)
   - Under the *Rules*, an RDFI must provide an ODFI with a copy of a Receiver’s WSUD within 10 banking days of receiving a written request (Subsection 3.12.7)
     - The proposed rule change substitutes a Message Entry for the written request
   - Currently, an ODFI’s written request, and an RDFI’s provision of the WSUD, take place manually outside the ACH Network
     - The proposed rule change requires the RDFI to respond via a Message Entry
     - The requested document could be uploaded into a trusted document repository that the ODFI would access
Use Cases for ACH Message Entries

4. ODFI Requested Returns
   - Under the Rules, an ODFI may request that an RDFI return an Erroneous Entry, or a credit entry originated without the authorization of the Originator (Subsection 2.12.2)
     - The RDFI has no obligation to respond, or to comply with the request
     - Currently, general industry practice is that an RDFI will require a Letter of Indemnification from the ODFI, even though the Rules contain an indemnification (Subsection 2.12.3)
   - Under the proposed rule, a Message Entry will serve as the ODFI's request for a return, and also serve the same purpose as the Letter of Indemnification
     - The RDFI either would return the original monetary entry; or
     - The RDFI would send a Message Entry that indicates it is not returning the original monetary entry
     - Under the proposed rule, it remains optional for the RDFI to comply with the request, but a response would be required
Use Cases for ACH Message Entries

5. Additional Information about an Originator
   – This use case is extended beyond the current Rules, which for entries to a non-Consumer Account or for BOC entries allow for the request of additional Originator information
     • The proposed rule would allow for this request to any entry
   – Currently, an RDFI’s request, and an ODFI’s response, take place manually outside the ACH Network
   – Message Entries would work just as with the Record of Authorization use case
     • The requested information would be saved into a document and be uploaded into a trusted document repository that the RDFI would access
   – Proposed rule language would require provision of the information within two Banking Days
     • This information is provided directly from ODFI’s records and should not require further contact or action to obtain
Use Cases for ACH Message Entries

6. Trace Messages

- Under the *Rules*, every ACH Entry and Return Entry includes an identifying Trace Number (Appendix Three – ACH Record Format Specifications)
- ODFIs and RDFIs occasionally have reason to inquire about the status of a ACH Entry or Return Entry
- Currently, any such inquiries take place are manual and take place outside the ACH Network
- A Message Entry would serve as either an ODFI’s or RDFI’s written request about the status of a previous ACH Entry or Return Entry; and the response to that inquiry would be provided via a responding Message Entry
  - The proposed rule requires a response within two Banking Days
  - This information is provided directly from the ODFI’s system and records, and should not require further contact or action to obtain
High percentages of RFI respondents agreed with the use cases selected for Message Entries.

- WSUD: 90% Agree, 2% Disagree, 3% Don’t Know, 2% No Opinion
- Record of Auth: 89% Agree, 3% Disagree, 5% Don’t Know, 2% No Opinion
- Source Doc: 83% Agree, 8% Disagree, 7% Don’t Know, 2% No Opinion
- Orig Info: 83% Agree, 10% Disagree, 2% Don’t Know, 2% No Opinion
- ODFI Req Return: 87% Agree, 8% Disagree, 2% Don’t Know, 3% No Opinion
- Trace Req: 82% Agree, 5% Disagree, 2% Don’t Know, 3% No Opinion
Proposal Rationale

• The ACH Message Entries proposal seeks to accomplish the following goals
  – Increase automation in ACH exception processing by eliminating various manual processes for request and fulfilment, and providing ubiquity of process
  – Increase the security of potentially sensitive information, such as name, account and routing numbers, by transmitting all information via the ACH Network
ACH Message Entries – Benefits

• Automating the process for sending and responding to requests via the ACH Network would provide the following benefits
  – A known and defined timeframe of receipt and traceability
  – The ability to pass requests downstream, to other units within an FI, or to Originators
  – Acceptance by regulators and auditors
  – Requiring a response to a request, whether negative or positive
• These benefits are describe in detail on the following slides
ACH Message Entries – Benefits

• The proposed rules would provide for a consistent and ubiquitous process
  – Use of Message Entries for requests and responses for the six use cases would be mandatory
    • The existing manual processes would be phased out
    • 74% of respondents to the DFI to DFI Messaging RFI agreed that, if adopted, use should be mandatory
  – Removes ambiguity in the submission process
    • Current back office processes include determining submission instructions (i.e., fax/mail/call, which department, which person, etc.) for each financial institution
    • All messages would include contact information for requesting and responding parties to facilitate further inquiries
  – Provides process consistency versus proprietary encrypted email solutions
    • Those that have tried to move the process forward have run into barriers with firewall issues for individual solutions
ACH Message Entries – Benefits

• Additional Security/Privacy
  – Secure electronic access to the ACH network limits existing risk of unmasked personal information potentially being exposed to unnecessary/unauthorized parties
  – The use of a trusted repository for documents mitigates the risk of unauthorized access
    • Authorized service providers currently provide similar databases to provide information in other payment systems
ACH Message Entries – Benefits

• Known timeframe of receipt
  – Certainty of electronic delivery and receipt would eliminate need for duplicate requests (other than for non-response)
  – Both DFIs to a request have identical information on the request and when the response time frame clock starts, the Settlement Date of the entry
  – Removes need to “slide” allowed response time due to non-receipt
ACH Message Entries – Benefits

• Ability to pass the request downstream
  – Electronic requests can be sent to:
    • Various areas of within a financial institution
    • Originators who need to respond to requests
  – Reduces manual labor needed to move paper requests
  – Decrease overall response time
  – Cleaner process for end-users (Originators) if they can obtain information at the same location/through the same process as they obtain data today (returns, NOCs, etc.)
ACH Message Entries – Benefits

• Acceptance by auditors
  – Electronic messages provide a greater audit trail than the current practice of manual requests and responses, including via paper documents, forms and/or letters
  – Eliminates the need for supplemental documentation (such as Letters of Indemnity) currently reviewed during Financial Institution audits
  • Letters of Indemnity are not required under the Rules, but are often required by an RDFI as evidence of an ODFI’s request for a return
ACH Message Entries – Benefits

• Mandatory response – negative or positive
  – A mandatory response required for any request that is sent
    • There is currently no requirement to respond to a request that cannot be completed
    • Responses would be included for:
      – Misrouted requests
      – Inability to comply with the request
    • This would provide significant efficiencies in the tracking and follow-up for all requests
  – 68% of RFI respondents agreed with the concept of mandatory message responses
ACH Message Entries – Request for Comment

• NACHA requests comment on all aspects of this proposal
  – Do you agree with the use cases?
    • Are there others that could make use of the Message Entry format?
  – Do you agree with the benefits?
  – Do you agree with the ubiquitous and mandatory requirements?
  – Do you agree with the required response times?
  – What are the impacts?
  – Do you agree with the proposed effective date and a single implementation?
ACH Message Entries: Automating Exception Processing via ACH

Request for Comment
Part 2 – Business Case Considerations
Opportunity Size

- In the 2017 DFI to DFI Messaging Request for Information, results around volumes, times spent doing various activities, and processes varied greatly based upon size.
- Most respondents indicated they were performing manual, time-consuming processes for:
  - Determining how/where to send the request
  - Tracking requests and duplicate handling
    - Making duplicate requests when status cannot be determined
    - Receiving and responding to the duplicates
- In addition to eliminating manual processes, handling requests via Message Entries could simplify activities related to demonstration of compliance
  - These compliance costs and potential savings are currently not included in the analysis
### Average Monthly Requests Made

Based upon the DFI to DFI Messaging RFI, over 1 million requests are made per month for all identified use cases, varying by institution.

<table>
<thead>
<tr>
<th>Totals</th>
<th>121,000</th>
<th>231,000</th>
<th>121,000</th>
<th>209,000</th>
<th>231,000</th>
<th>143,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>100%</td>
<td>0%</td>
<td>13%</td>
<td>7%</td>
<td>9%</td>
<td>14%</td>
<td>18%</td>
</tr>
<tr>
<td>80%</td>
<td>7%</td>
<td>15%</td>
<td>6%</td>
<td>9%</td>
<td>5%</td>
<td>7%</td>
</tr>
<tr>
<td>60%</td>
<td>38%</td>
<td>16%</td>
<td>36%</td>
<td>17%</td>
<td>29%</td>
<td>27%</td>
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<tr>
<td>40%</td>
<td>37%</td>
<td>9%</td>
<td>45%</td>
<td>31%</td>
<td>36%</td>
<td>40%</td>
</tr>
<tr>
<td>20%</td>
<td>27%</td>
<td>33%</td>
<td>28%</td>
<td>9%</td>
<td>5%</td>
<td>9%</td>
</tr>
<tr>
<td>0%</td>
<td>0%</td>
<td>1-10</td>
<td>10-25</td>
<td>25-50</td>
<td>50+</td>
<td>0%</td>
</tr>
</tbody>
</table>

Number of requests made per month
Steps to Make a Request

• RFI respondents identified steps taken when making a request and the time associated. While volume varies by institution, the same activities are performed by the majority.
• Based upon these activities, time being spent currently was identified and an average of 17 minutes of manual tasks, per request, could be saved through use of Message Entries.

<table>
<thead>
<tr>
<th></th>
<th>Determining department/staff to send the request*</th>
<th>Determining location/method to send the request*</th>
<th>Manual completion of request form*</th>
<th>Sending of the request</th>
<th>Tracking of outstanding requests</th>
</tr>
</thead>
<tbody>
<tr>
<td>WSUD Copy</td>
<td>71.1%</td>
<td>77.8%</td>
<td>84.4%</td>
<td>94.4%</td>
<td>91.1%</td>
</tr>
<tr>
<td>Record of Authorization</td>
<td>79.2%</td>
<td>81.2%</td>
<td>87.5%</td>
<td>87.5%</td>
<td>89.6%</td>
</tr>
<tr>
<td>Source Document</td>
<td>78.6%</td>
<td>85.7%</td>
<td>83.3%</td>
<td>85.7%</td>
<td>90.5%</td>
</tr>
<tr>
<td>Originator Information</td>
<td>69.6%</td>
<td>76.1%</td>
<td>54.3%</td>
<td>60.9%</td>
<td>63%</td>
</tr>
<tr>
<td>ODFI Requested Return</td>
<td>67.4%</td>
<td>82.6%</td>
<td>91.3%</td>
<td>91.3%</td>
<td>82.6%</td>
</tr>
<tr>
<td>Trace Request</td>
<td>71.8%</td>
<td>82%</td>
<td>74.4%</td>
<td>79.4%</td>
<td>76.9%</td>
</tr>
</tbody>
</table>

* Steps that could be eliminated with a messaging system.
Activity Analysis

Based upon RFI input, analysis was performed to determine that approximately 4 million hours could have been saved in 2017 by eliminating activities related to determining how to send requests and reducing duplicates by 50%.

Annual Hours Spent

<table>
<thead>
<tr>
<th>Activity</th>
<th>Hours</th>
</tr>
</thead>
<tbody>
<tr>
<td>WSUD</td>
<td>434,500</td>
</tr>
<tr>
<td>Record of Auth</td>
<td>959,200</td>
</tr>
<tr>
<td>Source Doc</td>
<td>392,700</td>
</tr>
<tr>
<td>Orig Info</td>
<td>752,400</td>
</tr>
<tr>
<td>ODFI Req Return</td>
<td>812,900</td>
</tr>
<tr>
<td>Trace Req</td>
<td>658,900</td>
</tr>
</tbody>
</table>
Total Potential Annual Savings

Utilizing the RFI information, it is estimated that eliminating manual steps through the use of Message Entries would save the financial institution community over 4 million hours in the first year. The chart below breaks that savings down by use case and calculates estimated staff cost savings.

Y1 Savings by Use Case

<table>
<thead>
<tr>
<th>Use Case</th>
<th>Hours Saved</th>
<th>Total FI Cost Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>WSUD</td>
<td>434,000</td>
<td>$10m</td>
</tr>
<tr>
<td>Record of Authorization</td>
<td>960,000</td>
<td>$23m</td>
</tr>
<tr>
<td>Source Document Copy</td>
<td>393,000</td>
<td>$9.4m</td>
</tr>
<tr>
<td>Originator Information</td>
<td>752,000</td>
<td>$18m</td>
</tr>
<tr>
<td>ODFI Requested Return</td>
<td>813,000</td>
<td>$19.5m</td>
</tr>
<tr>
<td>Trace Request</td>
<td>659,000</td>
<td>$15.8m</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>4m</strong></td>
<td><strong>$96.3m</strong></td>
</tr>
</tbody>
</table>
Potential Annual FI Savings

10 Year Potential FI Savings

Total: $1.3B

Note: Assumes 5% volume growth and 2% staff cost increase
ACH Message Entries: Automating Exception Processing via ACH

Request for Comment
Part 3 – Technical and Implementation Considerations
Technical Components

• Message Entries (using “MSG” SEC Code) with buildable Addenda Records are proposed to pass messages (requests and responses)
  – A Message Entry forward request would contain two Addenda Records (per request) and the response would maintain the original request addenda, adding two more containing response information
  – Each additional messaging Addenda Record would provide information to create a trail, “linking” it to the previous entry
  – The maximum number of allowed Addenda Records per Message Entry would be eight (under a corrected/contested dishonored Message Entry scenario)

• 85% of RFI respondents approved of the use of Addenda Records to carry message-related information, with 74% supporting the concept of buildable records.
Technical Components

• Document Repository Concept
  – For documentation requests, the use of a trusted third-party repository would facilitate access to documents

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Responders would upload the requested document to the repository</td>
</tr>
<tr>
<td>2</td>
<td>Repository would create an encrypted key, inserted into the response addenda record</td>
</tr>
<tr>
<td>3</td>
<td>Upon receipt, the requesting financial institution would utilize the encrypted key to securely access the document</td>
</tr>
</tbody>
</table>

– The repository is envisioned to work similar to that used for Federal Reserve Bank Check Adjustments
Technical Components

- The following new ACH format and data elements are proposed:
  - New Standard Entry Class Code - MSG
    - Allows for segregation of messaging batches
  - New Entry Description
    - Allows for batching of messages of different types
  - New Transaction Codes
  - New Addenda Type Codes
  - New Message Type Codes
  - New Response Codes
Technical Components

Most RFI respondents supported the new, proposed message entry formatting and codes:

<table>
<thead>
<tr>
<th>Formatting Code</th>
<th>Percentage Who Agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>New SEC Code</td>
<td>88%</td>
</tr>
<tr>
<td>Addenda Type Codes</td>
<td>85%</td>
</tr>
<tr>
<td>Message Type Codes</td>
<td>85%</td>
</tr>
<tr>
<td>Message Exception Response Codes</td>
<td>87%</td>
</tr>
<tr>
<td>Trace Status Response Codes</td>
<td>87%</td>
</tr>
<tr>
<td>Transaction Codes</td>
<td>87%</td>
</tr>
</tbody>
</table>
Technical Components

• New Transaction Codes Identify
  – Forward message request
  – A “No Response Received” follow-up
    • Would only be utilized after the required response time has elapsed
    • Would not require a separate response
  – Response to a message Entry; Dishonored Response; and a Corrected Response
Technical Components

- New Addenda Type Codes identify addenda records containing
  - Forward request data
  - Contact information
  - Response/Corrected response data
  - Exception responses
  - Dishonored responses
- New Message Type Codes identify the specific type of message
  - Allows for further routing inside the Financial Institution or to Originators to take action
Technical Components

• New Response Codes provide consistent values for
  – ACH Entry Trace Statuses
  – Misrouted Messages
  – Other Exception Responses
    • Inability to comply
      – Multiple reasons
    • Permission to return
    • Unreadable response
    • Document not as requested
Processing of Message Entries

- Message Entries would be eligible for submission to the ACH Operator at any time and would be processed in the next available exchange and settlement window
  - As a result, both request and response MSG Entries could be processed in Same Day ACH processing windows
  - Message Entries would not be subject to the Same Day ACH Fee, as request messages can be initiated from either an ODFI or RDFI
ACH Message Entries – Request for Comment

• NACHA requests comment on all aspects of these technical components
  – Do you agree with the new proposed codes?
    • SEC, Transaction, Addenda Type and new code types
  – Do you agree with the utilization of Addenda Records?
    • Should the records be buildable with the passing of each message?
  – How would you seek to interface with software to create messages and access a repository?
  – How would you prefer to implement this new messaging functionality?
Industry Synergies

- The Federal Reserve is researching expanding service offerings with its Exception Resolution Network
  - These two proposals are viewed as complementary, with the possibilities of the ERN providing:
    - Ability for a financial institution customer to view and respond to a case and optionally provide supporting documentation (repository)
    - Support the ability to upload/download files through an interface and/or API capabilities
    - Support the NACHA Message Entry by providing the ability to get entries into the ACH network
Implementation Considerations

• The ACH Message Entries proposal is considered to have considerable impact to Network Participants
• It is anticipated that these impacts would be offset by the efficiencies gained by substantially reducing or eliminating manual processes to make and respond to requests and duplicates, as well as the potential for future innovative uses taking advantage of the groundwork completed
  – While the ACH format work could be accomplished at one time, additional systems may need to be interfaced for full automation, as well as procedural and client interface changes
  – Comment is being requested on implementation considerations, such as phasing in mandatory use dates, perhaps by message type; and phasing out manual processes
Proposed Effective Date

• The proposed effective date for ACH Message Entries is September 18, 2020
  – Alternatively, if a phased implementation is preferred, certain use cases or responses messages could be implemented at a later date

• The effective date(s) is assumed to be dependent upon the effective date for Expanding Same Day ACH