Consumer Finance Monitor (Season 4, Episode 34): Nacha's Meaningful Modernization Rule: A Close Look at the Changes for Consumer Debit Authorizations and more

Speakers: Alan Kaplinsky, Jennifer Aguilar

Alan Kaplinsky:

Welcome to Consumer Finance Monitor Podcast, a podcast program sponsored by the Law Firm of Ballard Spahr. And in this podcast show, which we do weekly, we explore important new developments in the world of consumer financial services. We really cover the waterfront in our podcast show. And if you're listening to our podcast show, I would commend you, if you're not already a subscriber to our blog, consumerfinancemonitor.com, you should sign up for that because we've been doing the blog now for over 10 years. There is a tremendous amount of content on it, and indeed the topic we're going to be discussing today. There was very recently a blog post about the same content, the same topic I should say. So what we're going to be talking about today is Nacha. Okay. I'm not talking about nachos. A chip that you use to put salsa on it. I'm talking rather about the National Automated Clearing House Association. That's the formal name of the entity that we're talking about, but we'll never use that name again during our podcast.

Alan Kaplinsky:

We're going to refer to it by the name that everybody uses, namely Nacha. And Nacha deals with the automated clearing house or ACH transfers. Just to give you an idea of the volume of ACH transfers that are done every year, I was able to find information around 2020, there were nearly 27 billion ACH network payments that were made valued at, listen to this, $62 trillion in 2020 alone. Okay. And this is a growing system that is used to make payments. Nacha's not a government entity. I guess you could say, it's quasi-governmental. It was organized by the banking system, the banks, the SNLs, the credit unions, the depository institutions put this system together quite some time ago. And it's an alternative to using the wire transfer system or some other payment system that might be used. And so today, what we're going to talk about is some very recent changes to the Nacha operating rules that are going to go into effect in September.

Alan Kaplinsky:

And we'll get more into that a little later on. And as I indicated, there are private network rules governing the processing of ACH entries, and they govern the relationship between various parties to an ACH entry. Those that originate ACH's, the financial institutions, there are other third parties that process these ACH files and the account holders whose accounts are debited and credited. The Nacha rules include requirements for obtaining authorization to initiate ACH debits and credits to consumer and non-consumer accounts, making credits available to account holders and allowing for the return of unauthorized ACH entries. For consumer ACH entries, and this is very important to bear in mind, the Nacha rules, which we're going to talk about today, apply in addition to requirements set forth in the federal electronic fund transfers act and regulation E promulgated there under by the consumer financial protection bureau or the CFPB.

Alan Kaplinsky:

So let me now introduce our guests and our guest today is Jennifer Aguilar. Jennifer is a lawyer in our firm’s Consumer Financial Services Group, focusing her practice on payments, law, and rules. She regularly counsels clients on the Nacha operating rules, including drafting authorization agreements and advising on the various parties on the obligations that they have under the rules. Jennifer earned her accredited payments risk professional certification from Nacha in 2019. And she frequently presents on various ACH related topics, such as risk management, fraud and regulation E. She very recently joined

the faculty of Nacha's payments institute. So Jennifer, a very warm welcome to you. I know you very recently joined our firm Ballard Spahr, and this is the first time you've had an opportunity to be on our podcast show. And I am absolutely delighted to have you.

Jennifer Aguilar:

Thanks, Alan. I'm really excited to be here for my first podcast and talking about ACH, a topic I really enjoy, even though not everyone else does. It's certainly interesting and great for me. So I'm excited to be talking about it today.

Alan Kaplinsky:

Yeah. And it's an extremely important topic. So let's begin. I've got a number of questions that I have for you. The new rule is called the meaningful modernization rule. And there's been some rather extensive changes that have been made to the Nacha operating rules. Let's start from, I guess you could say... Well, let's build the foundation here. Let's level set. Can you give us an overview of how these changes came about? I assume there was some problem that existed that provided the impetus for the changes.

Jennifer Aguilar:

Right, so under the rules to help level set a little here for our audience, most of the changes we're going to talk about today are going to affect originators and ODFI's. So the originator is going to be the party in an ACH that is creating the file. They have a relationship with the consumer. So for example, like a bill payment company or your payroll company for employers, they're initiating those ACH files and they're called the originator. And under the roles, the way that they initiate different payment entries is under what's called an SEC code, a standard entry class code. And that SEC code is going to give all of the information and trigger all the requirements based on the type of entry. So for example, a telephone entry, the SEC code is tell, and it's going to say, you have to provide these security requirements, like verifying your receivers, identity and account.

Jennifer Aguilar:

It's going to have some disclosure requirements in it that's important based on that type of payment. There's also a web entry and again, has different types of security requirements because what we're worried about for a tell payment is different than what we'd be worried about for a web online payment. And then we also have entries related to checks like an RCK, which would be a re-initiated check payment. So instead of processing a check through the check system, it comes through the ACH system and all of these SEC codes trigger different requirements and obligations for originators under the rules. And sort of what's been happening over the last several decades with the ACH is that the way that consumers are making payments and interacting with these originators is changing. And this has created some inconsistencies to show up in the rules and some gaps to be identified because of these changes.

Jennifer Aguilar:

Now, historically ACH was done in paper. Consumers would come in, sign a form, and that would be their authorization. As we move to a more digital age, telephone and web payments are becoming much more popular. And the types of relationships that originators have with their consumers are also a little bit different, which is why we've gotten some of these changes. One of the big ones in it is the disclosure rules. So right now, like I mentioned for tells, there's a requirement to provide some disclosures about the payment, because the consumer doesn't have an opportunity to sort of see a form or read a form, Nacha felt it was important to have these disclosures provided orally to the consumers part of the telephone payment. All the other disclosure requirements are really broad. They're just going to say for other types of payments that the terms of the authorization has to be readily identifiable, and then just have clear and understandable terms.

Jennifer Aguilar:

And there's no specific things that have to be disclosed. So part of these changes is to make the standard for tells of all the required disclosures, like the payment amount, the payment date, and the frequency of payments and things like that across the

board to be a little bit more uniform. So regardless of whether the consumer is calling in to make a payment, doing it online, or doing it in person, it's important that they're getting those same disclosures across the board. So that's one of the really big changes that these rules made. The other issues that have come up that trigger the rules, changes here as well are issues with new technologies, such as internet videos and as well as the personal assistant devices. And through those, you're giving an oral authorization, but it's not really done over the phone. And so Nacha tried to find ways around that. How can we have oral authorizations under these rules in ways other than just a telephone payment? And we'll get into how they address that kind of going forward.

Jennifer Aguilar:

And then the final one that they dealt with here in these rules is the gap between a single and recurring entry. And right now all the rules say is that you can either have a one-time payment, or you can have a recurring payment that happens on a regular basis. And there's not really a way to facilitate payments through the ACH that aren't single, but also aren't quite recurring. If you have an ongoing relationship, but don't always know when the payments are going to go through or how much the payments are going to be for, you're sort of stuck doing a single payment every single time.

Jennifer Aguilar:

And you have to provide all the new authorizations and go through the security requirements. And sometimes you've been able to try to make it a recurring payment based on the disclosures you're providing or how you have it set up, but it's not really easy and it can be sort of clunky and confusing for consumers. So that was sort of the other issue that gave rise to these changes here. And as we go through our conversation today, and we'll talk in depth more about how Nacha resolve some of these issues in the new rule.

Alan Kaplinsky:

Yeah. So most of these changes, Jennifer, relate to authorizations for ACH entries. How do the amendments change what information must be included within the authorizations?

Jennifer Aguilar:

Right. So authorizations is a big, big piece of the Nacha rules. Essentially the foundational rule is that an originator must have authorization to initiate any entry to an account. And this includes both consumer and non-consumer accounts. It includes both debit and credit entries. So every originator essentially has to have permission to send ACH files through to a consumer or non-consumer account. So it's a really important foundational piece of the Nacha rules. And right now, like I mentioned, the telephone rules for consumers are the only ones that include those required disclosures. So what this rules change does, especially with regard to the authorizations and the required disclosures, is it changes how information and disclosures are provided for debit entries to consumer accounts. So it's important to note for the rules right now, credit entries can be authorized in any legal manner and that still stands. And that's just because of credit entry, you're pushing money into a consumer's account.

Jennifer Aguilar:

So we're a little less concerned with issues going about the wrong account or anything going wrong with the underlying payment because it's ultimately coming into a consumer's account and the issues arise much more when you have money coming out of a consumer account, which is that ACH debit. So the credit entries are still going to be authorized the same way. And that's both for consumer and non-consumer which any legal method is fine. The rules also will still provide an exemption for those P2P credit entries. So if you think through all of our P2P platforms, like our mobile apps like Cash App, for example, when they're using ACH or Zelle when they're using ACH, as long as the originator and the receiver are both natural persons, right, are consumers sending money to other consumers, those are still going to be exempt from the authorization rules. So even though we've got some substantial changes here, that all still stays the same with respect to credit entries.

Jennifer Aguilar:

So what's really changed here is the debit entries to consumer accounts. And what's happened is that the requirements for tells are now the standard across the board. So the tell standards are a little bit different, but stay basically the same pieces of information, but just how you provide it is a little bit different. So essentially going forward, every authorization for any type of ACH debit to a consumer account must include information about the type of payment that's going through. So whether it's a single entry and multiple entry or recurring entry, it will also have to include information about the amount of the payment, the timing of the payment and the account that the payment will be going to. Also has to include the name of, or identity of the receiver, as well as the date of that authorization. And then the final piece that's going to have to be included for all authorizations is information on how the consumer can revoke the payment.

Jennifer Aguilar:

Now for recurring and subsequent entries, this is pretty clear, there's an ongoing relationship, and it's pretty easy that if you want to cancel any going forward payments, the authorization will tell you how to go about doing that. For single entries, only those scheduled in advance are going to be subject to those revocation rules. So most companies process say for example, a one-time payment the same day that it comes in, there's not really going to be an opportunity for revocation in that way. So the disclosure would essentially just say that if you've scheduled it in advance, then here's how you would revoke it. And if you haven't scheduled in advance, then those disclosures just would not apply to that particular transaction.

Jennifer Aguilar:

And then finally, on the authorization points, there is still going to be authorization by notice. Mostly that comes up in our check conversion situations when you have an accounts receivable or a back office conversion, when a customer pays by check, and then it's transferred into an ACH file and processed through the ACH system instead of through the check system. So all that's going to also stay the same. So the big change will be for those web disclosures. It's going to be the most popular consumer disclosure and your PPDs as well. Those are going to have to now include all of these required disclosures, just like you would do for a telephone payment.

Alan Kaplinsky:

You know Jennifer, I neglected to get from you the exact date when these rules go into effect. So when is that? I said during my introduction September, but I wasn't sure of when in September.

Jennifer Aguilar:

September 17th is the trigger date. It is also fine to start implementing beforehand since these are new disclosure rules, it's not really going to affect anything that happens before that implementation date. So technically if you comply with all these disclosure requirements before, it's fine, it's not going to be a violation of the current rules or anything like that.

Alan Kaplinsky:

Yeah. And I guess one other thing, sort of a basic question, and that is what happens if there is a violation of the rules? If the originator doesn't follow these rules what's the result?

Jennifer Aguilar:

Right, so under the rules, anytime an entry is sent through the originator or the ODFI essentially warrant that they have complied with the rules. So they're promising to all the rest of the parties within the ACH system that they've complied and gotten the authorization and they've properly and done all the disclosures and sent the ACH through with authorization from the consumer. Anytime that that fails to happen, it's essentially just a violation of those warranties and they're on the hook for the amount of the money. So there's a process through the ACH where the receiver's bank, if the consumer says to their bank, I didn't authorize this money to come from my account, the receiver's bank can then go back to the originator's bank and ask for a copy of the authorization and they have to produce it. And the rules do change a little bit about that process.

Jennifer Aguilar:

And we'll talk about that a little bit later today, but when that happens, the ODFI or possibly its originator will pay the amount of that back to the consumer ultimately. And so anytime there's a rules violation, and when that's detected, if they're not able to say produce the authorization, or they're not able to produce all the disclosures that were required as part of that, and then they just have to pay the amount of the entry. So of course when we have recurring entries that could be a lot of money or if we have like big ticket ones, those will also be a lot of concerns. So the originator and the ODFI's would agree among themselves who's ultimately on the hook for it, depending on what's gone wrong in the process.

Alan Kaplinsky:

Yeah. And if you violate the rules, is it possible that you could get thrown out of the system and not allowed access to the ACH program?

Jennifer Aguilar:

Yeah, that can happen. It's very rare. And usually that's going to be reserved for really egregious violations and it's going to have to be something that's been ongoing for a really long time and that ultimately your actions have caused issues or a lot of harm to the ACH system itself. So Nacha have a system of fines in place so depending on the type of violation and whether it's your first violation or multiple violations and things like that. And there's some fines that can be levied. Usually most rules violations are just going to be agreed upon between the parties, the originator or its bank and the receiver's bank are going to agree sort of on how to resolve the issue. And when it becomes unresolvable between those parties, the RDFI can then go tell Nacha that you violated these rules and then Nacha could look into the situation and all of that, but unless it's something that's been going on for a really long time and they can't resolve it themselves, it's usually not going to amount to a reportable rules violation.

Alan Kaplinsky:

Got it. So let me get back to the rule again, the modernization rule, and it introduces the concept of a standing authorization and subsequent entries. What are they?

Jennifer Aguilar:

So this was Nacha's solution to the gap between the single entry and the recurring entry. So a standing authorization would be used when the consumer and the originator have an ongoing relationship, but they don't always know what the amounts of the payments are going to be between the parties or how often the payments are going to occur. If we think about our traditional recurring entry, it's usually a loan repayment, like a mortgage or a car loan. And you already know at the start of the transaction, how much each of those payments are going to be, when they're going to occur each month, so you can provide all those recurring information disclosures without any issues to your consumers. The standing authorization sort of contemplates when you don't have all of that information at the start of the relationship. You can sort of put in place the framework for the authorization, like the relationship between how you revoke it or the information about what account the funds are going to be coming from.

Jennifer Aguilar:

All of that can be decided ahead of time. And then you would use the subsequent entry to provide the rest of the information like the payment date and the payment amount. And the important difference between the standing authorization and subsequent entries is that the consumer actually has to take an affirmative action to initiate those subsequent entries. So right now, for a recurring entry, it happens automatically, the consumer doesn't have to do anything. So under the standing authorization, the consumer would take some kind of action. And that would be explained in the standing authorization itself what the consumer has to do to initiate those next payments. Part of what they've done here is that because of the required disclosures that are now for all of our authorizations, we have to disclose the payment amount and the payment date and

things like that. It makes a little bit harder to draft these authorizations when you have an ongoing relationship, but the terms aren't always known.

Jennifer Aguilar:

So the standing authorization creates a lot of flexibility for those originators to decide the relationship between the two parties without having to do the one-time entry, where you're providing all of the information every single time. So it's sort of a middle ground between our single and our recurring entries. The way that you can meet the disclosure requirements is through a combination of that standing authorization that you start out with, and then whatever that affirmative action is. So those two pieces together would constitute the full disclosures for your authorization. And then you would need to retain that as the record of authorization and should the ODFI request a copy of the authorization, you would have to provide both of those pieces. So it's important to keep in mind that too, it's a little bit different from a record retention piece, because both of those together would constitute your authorization.

Alan Kaplinsky:

So tell me Jennifer, what types of companies or relationships would benefit from implementing a standing authorization?

Jennifer Aguilar:

Right. So a lot of companies today that are doing some of those recurring entries, but under sort of wonky or weird authorizations would really benefit from this. One really good example are earned wage access companies that today they are doing some where you're repaying the amount that was advanced through an ACH that comes out of your account after you get paid, for example, and you don't know. Say the consumer gets paid every two weeks, but they may not take an advance every time that they are getting paid. It may be every other time. It may be once a month, it maybe once every three months, you don't really know. And you also wouldn't know how much they're getting advanced for each of those payments. So what you could do is set up the standing authorization to debit their account for the amount that they've advanced to themselves from those earned wages.

Jennifer Aguilar:

And then the consumer, when they go into the system to say, oh, I'd like to take an advance, that's where you provide the information about the date that you'll repay it and the amount that you'll repay without having to go back and provide all of the other information or confirm with them the account that needs to be debited, how they'd revoke and all the rest of those pieces of information, because that would already have been included in that standing authorization that you set up when you created the relationship with your consumer.

Jennifer Aguilar:

Another good example might be an employer employee relationship where an employee needs to pay out amounts, for example, if they have a company car that they've used for personal reasons to reimburse for those types of payments, that could be another great use case for it. An account transfer between your bank and your brokerage account would be another great example, because you wouldn't always know when you're going to transfer money out to a brokerage account or how much that might be. And so that's another good relationship there. Our e-wallets that we use, those consumer to consumer payments, those are always all over the place in amounts and who you're sending the money to and or who you're getting money from. That's another great example of another use case where this can be really, really useful. So essentially anytime you've got that ongoing relationship, this can be helpful.

Alan Kaplinsky:

Okay. So if a company permits consumers to authorize ACH debits in a variety of ways, such as in person, over the phone, online, does the standing authorization limit the consumer’s choices?

Jennifer Aguilar:

It does not. It actually provides originators a lot more flexibility in how they're processing the ACH payment. From the consumer side, the consumer experience is going to stay the same. If they still want to make a payment over the phone, then maybe next payment's going to be made online, the next one they're going to walk in. All of those will still be options for the consumer. It would just be set forth in that standing authorization. Here are the ways that you can initiate a payment each time you need to. On the originators end, what happens is that they get flexibility based on how they originally got that standing authorization, and then also how the consumer is making their payment. So say for example, the originator gets the standing authorization online. The next time, the first time a consumer wants to actually make a payment under that standing authorization, they can call in to the originator and give them the payment amount and the payment date and the rest of that information. The originator can then choose how to process that payment.

Jennifer Aguilar:

It can process it based on how the standing authorization was obtained in our example online. So you could process it as a web debit, or it could process it as a telephone transaction as a tell debit, because that's how the consumer initiated that subsequent entry. So you have both options are available and the reverse is also true. If you get the standing authorization over the phone and the next one is a web, you've got those choices between how you want to originate it. Now, originators can use some strategic choices of how they do that based on the security requirements. So like I said, there's different requirements for a telephone payment versus a web payment. And so depending on how your systems are set up, that you could possibly take advantage of the telephone rules and the telephone security requirements to sort of meet some of your web validation requirements by verifying your account through the first time you're doing it as a telephone transaction.

Jennifer Aguilar:

So it provides a lot more flexibility for originators too. There's two big exceptions that are important to mention that sort of limiting here. The first is that if you have that standing authorization and it was done as an oral authorization, such as over the phone or over the internet, or it was just a standard web authorization, you cannot identify any subsequent entries as a PPD. And that's more used for like in-person transactions. So that's not permitted, you'd have to continue using a tel. or a web or some other entry type based on how the subsequent entry is initiated. The other big exception is that if the consumer initiates that subsequent entry at an electronic terminal as defined by Regulation E then the originator has to identify that as either a POS, the point of sale or an MTE, which is the machine transfer entry. And so there's the two big caveats to it. But for the most part, most of the payments that originators are receiving are going to be their tel. or web, and they'll have that flexibility to choose.

Alan Kaplinsky:

Yeah, the meaningful modernization rule also introduces the concept of an oral authorization. How does that work?

Jennifer Aguilar:

Right, so this was the other solution that they came up with to some of our internet interactions or those personal assistant device interactions that consumers can have. And of course, over the last year and a half, we've all gotten very used to all of our video calls and all of that. And so this is a really nice way to capture those types of relationships and those types of payments through the internet. So if you have a video call with your consumer or any other relationship that you have, and you're doing it over your online but it's a video system instead of a telephone call, or it's possibly even like an internet call, we've got our ways to do those types of calls as well. It doesn't really fit within the definition of a telephone transaction. So in that case, what they've done is create this oral authorization category where you can say, I have obtained the authorization orally, but it's not actually a tell payment.

Jennifer Aguilar:

So in that case, most often it's going to be a web payment instead. And you would use the web debit and follow the web debit rules because you've obtained that usually over the internet in some way, whether it's through a video call or even like our personal assistant devices like Alexa or Siri, that would also be done over the web. When you are collecting that information that way over the web and using that web debit, it is important to know that that information that you're getting, the banking information, must either be encrypted or transmitted via a secure session. And that's in compliance with some of the security procedures that are set forth in article one of the Nacha rules. And so you do get a little bit of flexibility in how you're doing the oral authorizations, but just keep in mind that those other security requirements will kick in.

Alan Kaplinsky:

Okay. So what other changes, Jennifer, are important for our audience to know about?

Jennifer Aguilar:

Right, one is going to be with the process for the proof of authorizations. We talked a little bit earlier about, right, what happens if something goes wrong, who's on the hook for it? So one of the ways that that happens and is facilitated through the rules is if the consumer's bank asks for proof of authorization. The ODFI and the originator have to produce that. And if they can't produce it, then they're on the hook for the amount of the entry. What the process change is under the meaningful modernization rule is that instead of having to dig through all of your records and look for it, a ODFI can just simply say, I'm going to accept the return from the consumer's bank. I'm going to either I can't find it, or I know it's not done correctly. I'm just going to accept it without having to go through the time and expense of searching all of my records.

Jennifer Aguilar:

And this can happen for example, you've got a situation where you're dealing with fraud, especially in certain cases, the ODFI have now discovered that their originators aren't following the right processes, or they've discovered a fraud scheme going on with one of their originators. So it might just be easier for them to say, I'm already aware of the situation. I'm just going to accept the return. And that facilitates a lot of ease between the two parties without having to go pass records back and forth between each other and dispute over things. And so originators can just say, we're going to pay for it. End of story. Now the consumer's bank can still ask for it and can still say, well, we want a copy of it anyway, especially if it's something like a recurring authorization where they might have to go back several payments, and you're sort of outside the scope of the return under the Nacha rules. Under Nacha it's only 60 days.

Jennifer Aguilar:

So if you're outside the scope of that, there's reasons that your consumer's bank may still want a copy of that authorization, especially if the consumer has a fraud claim, they filed a police report, things like that. And so there's still reasons that even if the ODFI accepts return, that the RDFI will want that proof of authorization. So even though you can just say, I'm going to accept it, and that'll resolve a lot of issues under the rule, the RDFI's can still say, I want a copy of it anyway, and then the ODFI and the originator still have to comply with that. The other important change under the rules has to do with a written statement of an authorized debit. So this is one of the ones in the meaningful modernization rule that actually impacts the consumer's bank or RDFI's. In that case, when you're dealing with a fraud situation and the consumer is making a claim of unauthorized use, the receiving bank, in order to send that return entry back has to get this written statement from the consumer.

Jennifer Aguilar:

And it's essentially the consumer just saying I didn't authorize this, send it back. So the receiver can sign that, give it to their bank, and then they go back through the process of returning it to the ODFI. Right now, the rules are sort of silent on how the written statement of an authorized debit gets done by the consumer.

Jennifer Aguilar:

So, for example, right now there's a lot of implications under the rules that it has to be signed by the consumer, which people have been interpreted to say in-person signature has to be a wet signature. And so some have just taken advantage of the silence in the rules and done them electronically or orally. And that's sort of just created a lot of confusion in the industry. So the meaningful modernization rule just clearly outset says, you can do it electronically, you can do it orally, as long as it's signed or similarly authenticated, and you can show that that's sufficient. And so it gives those RDFI's a little bit more flexibility in how to collect that record, to then go back and initiate those return entries when there's been something wrong with the rules.

Alan Kaplinsky:

Got it. Okay. Well, Jennifer, we've drawn to the end of our program for today, and I want to thank you very much for sharing your unbelievable knowledge that you have about the Nacha rules. The other thing I want to tell the audience, something that I mentioned during my introduction, that you wrote an excellent blog article on our blog, Consumer Finance Monitor about these changes. And so if you're looking for more information, one good place to go would be the blog article. And I'm sure there will be other things that occur with the respect to Nacha rules over the next few years. And we'll definitely want to welcome you back to the program because you truly are a font of knowledge about these rules, which are a little bit esoteric to most people, but thank you again. And I want to also thank all of our listeners who downloaded the program today.