NACHA Operating Rules: Improving the Path between FIs & Third Parties

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• Image source: Thinkstock
Agenda

Points to cover:

- The definition of Third-Party Sender
- The definition of Third-Party Service Provider
- Obligations and responsibilities of Third-Party Service Providers and Third-Party Senders
- The Third-Party Sender and Third-Party Service Provider audit requirements
- The benefits to all participants in the ACH Network
Clarification of Third-Parties in the ACH Network

Approved December 6, 2013; Effective March 21, 2014

• Elements of the Rule change
  – Definition of Third-Party Sender
  – Definition of Third-Party Service Provider
  – Third-Party Sender and Third-Party Service Provider Audit Requirements
Originator Definition

• a Person [a natural person or Organization] that has authorized an ODFI (directly or through a Third Party Sender) to Transmit, for the account of that Person, a credit Entry, debit Entry, or Non-Monetary Entry to the Receiver’s account at the RDFI

• Layman’s Terms:
  – Originator = Ultimate beneficiary of receipt of the payment or the participant ultimately responsible for making the payment
Third-Party Service Provider Definition

• an Organization that performs any functions on behalf of the Originator, the Third-Party Sender, the ODFI, or the RDFI (not including the Originator, ODFI or RDFI acting in such capacity for such Entries) related to the processing of Entries, including the creation of the Files* or acting as a Sending Point or Receiving Point on behalf of a Participating DFI. An Organization acting as Third-Party Sender also is a Third-Party Service Provider.
Third-Party Service Provider Definition

*Creation of Files: means actually performing data processing functions necessary to generate Files that can be delivered to the ODFI or to another Third-Party Service Provider or ACH Operator at the ODFI’s direction.

• Note: An Organization that provides hardware or software to the ODFI, but does not perform such data processing functions is not a Third-Party Service Provider.
Birth of the Third-Party Sender
Introduction to the Rules
Third Party Sender Definition

- a type of Third-Party Service Provider that acts as an intermediary in Transmitting Entries between an Originator and an ODFI, including through Direct Access, and acts on behalf of an Originator or another Third-Party Sender. A Third-Party Sender must have an Origination Agreement with the ODFI of the Entry. A Third-Party Sender is never the Originator for Entries it Transmits on behalf of another Organization. However, a Third-Party Sender of Entries may also be an Originator of other Entries in its own right.
ACH Flow- With Third Party Sender

Authorization
Receiver

TPS
Operator
TPSPs

RDFI
BANK

CONTRACT
Agreement

ODFI
BANK

CONTRACT
Agreement
Clarification of Third-Parties in the ACH Network

Approved December 6, 2013; Effective March 21, 2014

- Third-Party Sender and Third-Party Service Provider Audit Requirements
- Modifies titles and some language in rules compliance audit requirements to specifically state whether the audit provision applies to Third-Party Senders and Third-Party Service Providers
- Ensures that the Third-Party Sender and Third-Party Service Provider responsibility to perform an annual rules compliance audit (to the extent they perform obligations of an ODFI or RDFI) is obvious to all Network participants
  - Includes a minor change for improved readability
  - Rules audit changes apply to audits required to be completed by December 31, 2014
## Rule Compliance Audit Requirements

### Quick Reference Guide of Applicability of Appendix Eight Provisions to Third Parties

*Note: This table is presented for informational purposes; in the case of a discrepancy between information in this table and the Rules, the Rules prevail.*

### Part 8.2 Audit Requirements for All Participating DFIs, Third-Party Service Providers, and Third-Party Senders

Third-Party Service Providers and Third-Party Senders must audit on the requirements indicated below.

<table>
<thead>
<tr>
<th>Rule</th>
<th>Description</th>
<th>Rule is Applicable to:</th>
</tr>
</thead>
</table>
| **8.2.a** | Retains record of Entry for six years; can provide information relating to the Entry upon request | Third-Party Service Provider to RDFI*: Yes  
Third-Party Service Provider to ODFI*: Yes  
Third-Party Sender**: Yes |
| **8.2.b** | Verifies that an electronic form of a record required by Rules in electronic form accurately reflects the record and can be accurately reproduced | Yes  
Yes  
Yes |
| **8.2.c** | Conducts audit | Yes  
Yes  
Yes |
| **8.2.d** | Encrypts banking data and secures sessions | Yes  
Yes  
Yes |
| **8.2.e** | Pays Network Administration Fees | No  
No  
No |
| **8.2.f** | Conducts ACH risk assessment and has risk management program | Yes  
Yes  
Yes |
| **8.2.g** | Verifies that security policies, procedures and systems have been established, implemented and updated | Yes  
Yes  
Yes |
## Third-Party Sender and Service Provider Audits

### Rule Compliance Audit Requirements

**Quick Reference Guide of Applicability of Appendix Eight Provisions to Third Parties**

*Note: This table is presented for informational purposes; in the case of a discrepancy between information in this table and the Rules, the Rules prevail.*

<table>
<thead>
<tr>
<th>Part 8.3</th>
<th>Audit Requirements for RDFIs and Third-Party Service Providers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Third-Party Service Providers must audit on the requirements indicated below.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Brief description of each rule is shown below.</th>
<th>Rule is Applicable to:</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Rules Summary</strong></td>
<td>Third-Party Service Provider to RDFI*</td>
</tr>
<tr>
<td><strong>R.3.a</strong></td>
<td>Verifies prenote account number; responds with Return or Notification of Change when appropriate</td>
</tr>
<tr>
<td><strong>R.3.b</strong></td>
<td>Meets NOC timeframes</td>
</tr>
<tr>
<td><strong>R.3.c</strong></td>
<td>Accepts all entries; handles XCK entries and entries to non-transaction accounts appropriately</td>
</tr>
<tr>
<td><strong>R.3.d</strong></td>
<td>Makes credits available on timely basis; posts debits on timely basis</td>
</tr>
<tr>
<td><strong>R.3.e</strong></td>
<td>Provides or makes available required Entry information to consumer account holders; for non-consumer accounts, provides or makes available contents of Check Serial Number Field for certain SEC Codes</td>
</tr>
<tr>
<td><strong>R.3.f</strong></td>
<td>Transmits returns and contested and corrected returns on a timely basis; verifies that late returns of CCD or CTX entries and dishonored return entries are handled appropriately</td>
</tr>
<tr>
<td><strong>R.3.g</strong></td>
<td>Returns RCK entries on a timely basis</td>
</tr>
<tr>
<td><strong>R.3.h</strong></td>
<td>Returns credits on a timely basis</td>
</tr>
<tr>
<td><strong>R.3.i</strong></td>
<td>Honors stop payments and uses appropriate Return Reason Codes for stop payments</td>
</tr>
<tr>
<td><strong>R.3.j</strong></td>
<td>Obtains Written Statements of Unauthorized Debit for certain returns; transmits Extended Return Entry by deadline; provides copies of Written Statement of Unauthorized Debits on a timely basis</td>
</tr>
<tr>
<td><strong>R.3.k</strong></td>
<td>Provides proper UCC4A notice to Receiver</td>
</tr>
<tr>
<td><strong>R.3.l</strong></td>
<td>Provides information from Addenda Records accompanying a CCD, CTX, CIE or IAT Entry upon request</td>
</tr>
</tbody>
</table>
## Third-Party Sender and Service Provider Audits

### Rule Compliance Audit Requirements

Quick Reference Guide of Applicability of Appendix Eight Provisions to Third Parties

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<th>Provision</th>
<th>Rules Summary</th>
<th>Rule is Applicable to:</th>
</tr>
</thead>
<tbody>
<tr>
<td>8.4.a</td>
<td>Has proper origination agreements with Originators/TPSs</td>
<td>Third-Party Service Provider to RDFI*</td>
</tr>
<tr>
<td>8.4.b</td>
<td>Has proper Sending Point agreements</td>
<td>Third-Party Service Provider to ODFI*</td>
</tr>
<tr>
<td>8.4.c</td>
<td>Assesses risk; establishes, implements and enforces exposure limits; monitors Originator/TPS origination and return activity</td>
<td>Third-Party Service Provider to RDFI*</td>
</tr>
<tr>
<td>8.4.d</td>
<td>Accepts Return Entries and extended Return Entries; transmits dishonored Return Entries on a timely basis. Uses appropriate return reason codes.</td>
<td>Third-Party Service Provider to RDFI*</td>
</tr>
<tr>
<td>8.4.e</td>
<td>Provides information around NOCs to Originator or TPS; transmits refused NOCs on a timely basis</td>
<td>Third-Party Service Provider to RDFI*</td>
</tr>
<tr>
<td>8.4.f</td>
<td>Provides proof of authorization upon request on a timely basis</td>
<td>Third-Party Service Provider to RDFI*</td>
</tr>
<tr>
<td>8.4.g</td>
<td>Accepts late returns when agreed</td>
<td>Third-Party Service Provider to RDFI*</td>
</tr>
<tr>
<td>8.4.h</td>
<td>Provides proper UCC4A notice to Originator</td>
<td>Third-Party Service Provider to RDFI*</td>
</tr>
<tr>
<td>8.4.i</td>
<td>Utilizes commercially reasonable methods to establish the identity of Originators/TPSs that enter into origination agreements; verifies that Third-Party Sender utilizes commercially reasonable method to establish identity of Originators that enters into origination agreements with the Third-Party Sender</td>
<td>Third-Party Service Provider to RDFI*</td>
</tr>
<tr>
<td>8.4.j</td>
<td>Initiates Reversing Entries and Reversing Files in accordance with the Rules</td>
<td>Third-Party Service Provider to RDFI*</td>
</tr>
<tr>
<td>8.4.k</td>
<td>Establishes and implements commercially reasonable procedures to verify the identity of each Originator Third-Party Sender of BOC entries; documents specific information with respect to each Originator and provides information to RDFI on a timely basis</td>
<td>Third-Party Service Provider to RDFI*</td>
</tr>
<tr>
<td>8.4.l</td>
<td>Provides return rate information to NACHA upon request</td>
<td>Third-Party Service Provider to RDFI*</td>
</tr>
<tr>
<td>8.4.m</td>
<td>Registers Direct Access status with NACHA; obtains appropriate internal approval for each Direct Access Debit Participant; provides required reporting, notifies NACHA of changes to information previously provided</td>
<td>Third-Party Service Provider to RDFI*</td>
</tr>
<tr>
<td>8.4.n</td>
<td>Informs Originators/TPSs of responsibilities</td>
<td>Third-Party Service Provider to RDFI*</td>
</tr>
</tbody>
</table>
How to spot a Third Party Sender

• 3 Chances
  – During the initial approval and on-boarding process
  – During the implementation and testing process
  – During routine reviews
During Initial Approval and On-boarding Process

• Questions on the originator application
• Review of the type of business
• Review of previous activity if accessible
• Underwriting process
  – Limit established for expected business of multiple Originators
### Key Words for Identifying Third-Party Senders

| ✓ Management     | ✓ Community      |
| ✓ Professional  | ✓ CPA/CPA’s      |
| ✓ Property       | ✓ Employer       |
| ✓ Services       | ✓ Employee       |
| ✓ Staff          | ✓ Employment     |
| ✓ Staffing       | ✓ Financial      |
| ✓ Subscription  | ✓ Force          |
| ✓ Tax            | ✓ Fee            |
| ✓ Temp           | ✓ Telephone      |
| ✓ Temporary      | ✓ Lease          |
| ✓ Work           | ✓ Leasing        |
During the Implementation and Testing Process

- Requests for multiple Company IDs
- Company Name in test file is something other than what they are known to you as
During Routine Reviews

- Periodic spikes in volumes and exception volumes
- Multiple requests for file increases
- Multiple breaches of exposure limits
Scenario #1

- Property Management Company (PMC) has agreement with ODFI to originate debit and credit entries
- PMC has relationship with several owners of apartment complexes and agreements are in place between owners and PMC
Scenario #1

- PMC obtains authorizations from renters to initiate monthly debits for rent payments
- Authorization specifies it is between the renter and PMC (on behalf of the owner)
Scenario #1

- Lease is with the owner but renters deal directly with PMC
- Is this a TPS situation?
Scenario #1

• Whose name is in the Company Name Field?
  – PMC is a TPS, acting as an agent for the owners
  – The renter signed a lease with the owner, not PMC, so the owner is the ultimate payee even though PMC holds the authorization
  – The owner’s name should be in the Company Name Field
Scenario #2 and #3

- USA Payroll Processor has agreement with ODFI to originate credit and debit entries for over 2,000 companies across the US
- USA Payroll has two distinct client relationships
  - Administrative Services Organization (ASO), similar to PEO but do not create a co-employment relationship
  - Professional Employer Organization (PEO), creates a co-employment relationship
Scenario #2

- USA Payroll has 1,000 ASO relationships
  - USA Payroll holds authorizations (for the employer) for 600 clients
  - 400 clients, employers hold authorizations
- Is this a TPS situation?
Scenario #2

- Whose name is in the Company Name Field?
  - USA Payroll is a TPS, acting as an agent on behalf of the employee’s employer
  - In some cases the employer has requested USA Payroll hold authorizations
  - The employer’s name should be in the Company Name Field
Scenario #3

- USA Payroll has 1,000 PEO relationships
  - USA Payroll holds all authorizations with employees
  - Authorization is between employee and USA Payroll
- Is this a TPS situation?
Scenario #3

- Whose name is in the Company Name Field?
  - USA Payroll is a co-employer and they are legally responsible for wages
  - Therefore, they are an Originator, not a Third-Party Sender
  - The Company Name Field could be populated with USA Payroll or the Company
Nested Third-Party Senders – A Complicated Hand

- Greenback Processing, a Third-Party Sender, processed through Elm Street Bank

Elm Street Bank

Third-Party Sender #1

Greenback Processing (TPS #2)

Third-Party Sender #3
Nested Third-Party Senders – A Complicated Hand

- A closer look at Greenback’s portfolio

- Payroll Processors
- Small Businesses
- Rental Agencies
- Renters
- Property Management Cos
- Renter, Home Owners
- Tuition Processors
- Schools, Learning Centers
- Pay Day Lenders
- Collection Agencies
SOUND BUSINESS PRACTICES
Conduct Due Diligence on Third-Party Sender or Service Provider

• Collect Basic Information
  – Name and all “doing business as (dba)” names
  – Address
  – Phone number
  – Type of business or principal business activity
  – Tax ID number
  – Principal’s names, etc.

• KYC, KYCC, KYCCC Policies
  – Who is the third party sender doing business with?

• Ensure selection of TPSender and their clients fits with the risk appetite of the bank
Conduct Due Diligence on Third-Party Sender or Service Provider

• Due Diligence should also include at a minimum:
  – Review the third party’s Web site, advertising, marketing, scripts, products, and services.
  – Determine whether the third party supports high-risk businesses or businesses prohibited by the ODFI. The ODFI has to define this list in its risk policies.
  – Visit the third party’s physical location if reasonably practicable.
  – Beware of third parties that use a Post Office Box.
  – Request and verify business references.
  – Perform credit analysis, etc.

• Procedures for checking legitimate sources
  – O.W.L.
  – T.O.D.
Ensure Agreements Include Necessary Provisions

- Compliance with Rules and Applicable Law
- Transmittal of Entries and Security Procedures
- Physical and Electronic Security
- Right to Audit
- Termination Policy and Procedures
- Requirement to perform ACH Audit
Monitor Third-Party Relationships

• Perform an annual review of the financial condition and credit reports of the principal(s).

• Take a risk-based monitoring approach to Third-Party Sender activities (as a whole) and individual Originator’s activities.

• Review the Originator list provided by the third party

• Review company names and types of businesses

• Perform background checks on random sample of Originators

• Monitor the Third-Party Sender’s Originators’ activities
  – Look for red flags such as more than one Originator debiting the same consumer accounts
  – Review incoming and outgoing wires associated with ACH settlement
Regulator and Examiner Expectations

• Financial Institution Letter, FIL-3-12, 1/31/12, Payment Processor Relationships
  – Highlights:
    • TP that process payments for merchants require careful due diligence, close monitoring, and underwriting
    • Account relationships with high-risk entities pose increased risk
    • Certain types of payments processors pose increased money laundering and fraud risks
Regulator and Examiner Expectations

– Highlights (cont’d):
  • FIs should assess risk tolerance in overall risk assessment program
  • FIs should be in tune with consumer complaints and return rates
  • FIs should react immediately to fraudulent or improper activities
  • Improperly managing these risks may result in monetary penalties

Regulatory Requirements and Guidance

- OCC Bulletin 2008-12, Payment Processors, April 24, 2008
- FFIEC Retail Payment Systems IT Examination, February 2010
- FDIC FIL-3-2012, Payment Processor Relationships
- FIN-2012-A010, Risk Associated with Third-Party Payment Processors, October 22, 2012
Third-Party Senders and the ACH Network Publication
Questions?

Type your question in the bottom of the Q&A Pod on your screen. To submit your question, click Send to the right of the text box, or press return.
Contact The Presenters

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Join us at 2014 Payments Conference on Tuesday, April 8, 2014 at 10 a.m. – 11:15 a.m. for a deeper dive into this Third-Party Topic!!!