American Bankers Association
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December 12, 2011

Maribel Bondoc
Manager, Network Rules
NACHA, The Electronic Payments Association
13450 Sunrise Valley Drive
Herndon, VA 20171

Re: Expedited Processing and Settlement, Request for Comment

Dear Ms. Bondoc:

The American Bankers Association (ABA)[1] respectfully submits its comments to NACHA, The Electronic Payments Association, on the Expedited Processing and Settlement request for comment (RFC) published on September 23, 2011. ABA appreciates NACHA's efforts to improve the Automated Clearing House (ACH) network by making it more attractive to its users. The RFC invites comment from the industry on the proposal that would enable ACH entries to be processed and settled on the same day that they are originated.

The expedited processing and settlement (EPS) proposal represents a material shift in the mission of the ACH network that has been dedicated to providing safe, secure, and efficient processing of low dollar value transactions using an overnight batch process. ACH is also the backbone of check conversion and electronic bill pay. As such it represents a strong foundation for the traditional banking industry payments system franchise.

The proposed change would enable certain payments to be processed on the same day, allowing the ACH network to offer an expedited service that could be more competitive with other payment channels. While whenever systems change there will be trade-offs; special care should be taken when tinkering with such a fundamental payments system network that represents banks of all sizes. Approaching the proposed changes with such prudent caution, ABA and its members do not believe the proposal demonstrates a viable business case for this service at this time given the uncertainty of delivering benefits attractive enough to customers to be willing to pay for the service to compensate the investments required by participants to provide it.

ABA recommends that this proposal be subject to additional evaluation to ensure that it be enacted correctly and not just quickly. ABA recommends that this proposed rule be re-proposed in 2012 based upon responses received during this current comment period and subsequent study addressing those comments, with the effective date delayed until 24 months after a final rule is

[1] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $13 trillion banking industry and its 2 million employees. ABA's extensive resources enhance the success of the nation's banks and strengthen America's economy and communities. Learn more at www.aba.com.

approved, if it is approved. At this time, ABA does not believe the business case has been made to warrant proceeding with these changes as proposed.

Summary of the Proposed Rule

NACHA requests feedback from the payments industry regarding a request for comment on its proposal to add a new window while preserving the existing overnight ACH processing schedule. In the current environment, if a bank customer sent a file to their ODFI at 1 pm the payment would not be processed until the next business day. Under the proposed rule, this cycle would shortened and allow for faster settlement. The new EPS window would have a file submission deadline for ODFIs of 2 pm Eastern Time with output files to Receiving Depositary Financial Institutions (RDFIs) no later than 4 pm. This will allow some ACH transactions to be processed on the same day they are originated.

This rule change would be mandatory for all RDFIs, but Originating Depositary Financial Institutions (ODFIs) would have the option of originating EPS transactions. Implementing EPS would require that all RDFIs absorb the costs of implementing the change and also the expenses related to adding an additional daily ACH pick up window in perpetuity. Banks that are ODFIs may or may not choose to offer this new expedited payment service to their customers for a fee, but the revenue/expense equation remains uncertain, even for them without better information about market demand. There is no revenue stream identified to directly compensate RDFIs for enabling this service.

NACHA cites several potential benefits for making this proposal including meeting consumer demand for faster transactions and the need to keep the ACH network competitive in a changing payments environment. This would be similar to efforts in other countries to accelerate batch payment processing. NACHA also notes that faster clearance and settlement mitigates counterparty, systemic, and liquidity risk.

ABA Response Regarding the Request for Comment

In assessing the changes proposed by NACHA, ABA has considered the potential benefit of the proposed changes, the cost to implement these changes, and the effective dates of the changes. In cases where there is a low implementation cost there is a correspondingly lower threshold for evaluating the potential benefit of the change. Conversely, where the cost of implementation is high or difficult to define, the potential benefit of the change must be held to a higher standard. It is very difficult to define the potential benefits related to the EPS proposal.

This proposal represents a significant shift in the ACH network business model. It expands the ACH network beyond its strengths of safe, efficient, and inexpensive overnight batch processing in order to compete with payment models that are faster. The intent is good, but all the potential costs must be weighed against any potential benefits to ensure that the changes make sense. Making the change without a practical business case for the new service taking into consideration ODFIs, RDFIs, and the customers who would drive the transactions is very important. There should be an expectation that future revenues will offset expenses.

The proposal focuses on increasing volume on the ACH network. However, banks support multiple payment networks including check, wire, and debit and credit cards. Banks must view the payment system in its entirety as a portfolio of services and not focus on one specific delivery method. Changes to one system that could unduly harm another or cause overall decreases in income must be reviewed carefully.

Analysis

RDFIs

This proposal will have a significant effect on a large number of financial institutions that will act solely as RDFIs, meaning that they will not be able to take advantage of any possible revenue opportunities associated with originating the transactions. This is a mandatory change for RDFIs and that means absorbing the costs of implementation and then ongoing processing expenses in perpetuity.

The proposal cites two NACHA surveys on RDFIs and their procedures for picking up ACH files. In May 2007, NACHA found that 30% of RDFIs picked up their files once per day. Another survey in December 2010 found that 47% of RDFIs picked up their files once per day. Under the proposal, all financial institutions would have to pick up their files at least twice per day, doubling the pickups for a substantial number of banks and credit unions.

As of September 2011, there were 7,179 federally insured credit unions and 7,436 federally insured banks in the United States.[2] Given NACHA's own estimates, between 4,384 and 6,869 financial institutions will need to change their policies and procedures related to ACH file pick ups, and absorb the additional expenses, to comply with this proposal.

NACHA conducted another study in April/May 2011 indicating in the RFC that 75-85% of the RDFIs believed that implementation and systems integration related to opening another window for expedited processing and settlement would only require a "light to medium" effort. Further review disclosed that the breakdown of the categories was approximately 35% "light," 45% "medium," and 10% "high." If accurate, that would mean that approximately 55% of RDFIs, or about 8,038 financial institutions, believe this to be a "medium to high effort" exercise.

ODFIs

Banks must make their decisions to offer new products based on several factors. The most significant factor is the estimated demand for the product. In the case of ACH transactions, how many payments per year are forecast for the new EPS ACH product? Without confidence in this projected number, it is problematic for any financial institution to construct a financial model that would support the business case for pursuing the new product.

The uncertainty regarding the market demand for this service compounds the difficulty of bank efforts to construct a profitable business opportunity without undermining the value that the

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[2] Statistics gathered from the National Credit Union Administration and the Federal Deposit Insurance Corporation.

ACH payment system currently affords participants. This calculation is stressed further by the short implementation timeline in the proposal that will disrupt system and policy upgrades in thousands of financial institutions. RDFIs face a net loss of ACH revenue unless they can generate compensating revenue by electing to be an ODFI. Yet in general, and in this case, the shorter the timeline, the more expensive the implementation becomes. Increasing implementation expenses makes it more difficult to justify becoming an ODFI if the market demand for the service is not readily identifiable and defined. It is not enough just to build something and hope that demand will justify it.

Recent economic difficulties have made banks more cautious regarding investments in new products. Currently, it does not appear that there is a critical mass of evidence that there is a large demand for an expedited ACH product. The proposal estimates that 4% of wire transactions may migrate to the new EPS ACH product. Yet realizing even this projection is dependent on each ODFI making an independent assessment about its individual mix of alternative payment channel offerings, including wires and conventional ACH transactions, and deciding whether the trade-offs among the options results in sufficient demand to improve overall returns for its own business model.

Forecasting demand for the EPS ACH product is difficult. In pages 5-9 of the proposal NACHA outlines several potential product opportunities that the new product may spur. It cites a recent survey by the Association of Financial Professionals (AFP) listing "Same-Day Settlement" ranked first for bottom-line value.

A review of the 2010 AFP survey indicates that its members are interested in same-day ACH transactions less than 50% of the time across payment types. The corporate respondents were asked about same-day settlement and the likelihood of them using it for different types of payments. The survey did not ask the corporate respondents about fees associated with these payments.

<u>NACHA Proposal Citing Potential Enhancements to ACH Products</u>

- Direct Deposit/Payroll Processing
- Consumer Debits for Bill Payment and Other Purposes
- Consumer Payments via Online and Mobile Banking Applications
- Disaster Assistance
- Tax Payments
- Cash Concentration
- Reversals
- Administrative Transactions
- New Applications

2010 AFP Survey, percentage represents AFP survey respondents who would be likely to use same-day ACH service for certain types of payments.[3]

- 58% Tax payments
- 43% Cash concentration
- 41% Payroll
- 39% Consumer/e-check services available today
- 38% Consumer ACH credit payments
- 22% Corporate payments requiring cash on delivery
- 19% Cross-Border payments

The AFP survey question results indicate that there is more than 50% demand for only one payment type, taxes. It is not clear whether the survey respondents were asked to answer the question assuming that the transaction was assessed a standard ACH rate or if there was a premium fee involved.

It appears that cash concentration transactions, payroll, and consumer ACH/online payments may be those most attractive payment types to help the transition to a premium EPS ACH product. They should be subject to additional review to determine what percentage of these payment types may benefit from quicker processing.

Corporations using wires for cash concentration may not benefit from a quicker transaction using EPS ACH, but they may trade that benefit for a lower cost per payment. It would be valuable to learn the volume of cash concentration transactions now in order to estimate the potential that could be conducted using the new product.

Standard payrolls would not benefit from faster settlement if the originator is able to submit the files in a timely manner. But, if there is a problem with the payroll file, the EPS ACH product may be very useful. In order to pay their employees on time, employers would likely be willing to pay a premium to avoid disruption. It would be valuable to have more evidence regarding the numbers of late payrolls that are processed annually. This would allow the market to estimate another potential revenue stream for the EPS ACH product.

Some consumer online payments may shift to EPS ACH but, like payroll, if there is enough time to plan ahead and set the payment up ahead of schedule then there is no need to pay for a premium service. However, if a consumer can make an EPS ACH payment for a same day transaction to avoid a late fee on a credit card or to keep the electricity turned on in their house, they would find this a very attractive alternative. This premium ACH service would be less expensive than a wire and probably would be less than any late fees or penalties that would be assessed by the payee. It would be valuable to have more information regarding the volume of payments made to avoid late payments that could benefit from the EPS ACH.

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[3] 2010 AFP Electronic Payment Survey, www.**afponline**.org/**epaysurvey**/

EPS ACH may present opportunities to speed consumer collections. This would allow transactions conducted before the cut-off point to be debited from consumer accounts on the same day. In particular, this could benefit ACH debits authorized over the telephone, the Internet, and processed at lockboxes. Nevertheless, the question remains whether the value of this acceleration supports fees adequate to warrant making the option available.

Dollar Limits

The proposal asks for input regarding setting dollar cap limits on individual EPS transactions at either $25,000 or $100,000. The basic economic question revolves around whether the $100,000 cap would allow additional volume be processed via EPS ACH that would justify the additional risk of errors and fraud associated with the higher dollar volume. Or conversely, whether a lower cap of $25,000 would lower the risk associated with errors and fraud to justify foregoing the additional volume a higher cap would allow. The $25,000 limit corresponds to existing ACH limits on ARC, BOC, and POP transactions.

Additional information is needed to help solve this equation. Knowing the mix of payments that are interested in adopting EPS ACH would help to build the business case and assess associated risk. A study could provide more details on how many transactions under $25,000 and how many between $25,000 and $100,000 would be expected to move to EPS ACH. Breaking down these transactions by type (tax payment, cash concentration, P2P) would help to assess the risk associated with the payments. If payments assigned a higher risk level are also determined to have a larger dollar value, then that would recommend an even lower cap. Right now the information is unavailable and that makes it difficult to make a confident recommendation.

Given the current state of knowledge, it makes sense to consider beginning with the $25,000 cap on individual transactions when the rule becomes effective. This may reduce the total number of transactions qualifying to be processed as EPS ACH, but more importantly it would mitigate the risk to RDFIs and ODFIs at the outset of the program. The proposal recommends the dollar limit be reviewed annually. If the activity warrants, the dollar limit could be moved up or down annually as need.

To reduce the threat of potential problems associated with RDFIs receiving large late day credits or debits that will affect their balances, we recommend that the ACH Operators be made responsible for filtering any EPS ACH transactions that are over the dollar cap limit. This will require coordination with the ACH Operators to ensure that they can change their policies, procedures, and capabilities to block transactions in excess of the dollar caps.

Risk Management

The EPS ACH proposal would mitigate risk in certain areas outlined in the NACHA document, but it could also impede the benefits to consumers of banks that offer ACH Positive Pay or Controlled Disbursement products. In general, ACH Positive Pay products allow a bank to provide a list of incoming ACH transactions to a customer prior to them being settled. The customer can determine if the transactions are valid and should be funded. Transactions that are inaccurate can be returned. ACH Positive Pay products are the first line of defense of corporations interested in preventing corporate account takeover fraud using the ACH network to disburse the funds.

Under EPS ACH, if a fraudulent ACH transaction is received by an RDFI at 4 pm Eastern with settlement required at 5 pm Eastern, the window to validate those transactions is barely open. The possible impact of this narrow window is that fewer transactions fraudulent transactions will be identified and stopped. Consequently, this would make this premium feature less attractive to corporate customers, further reducing bank revenues.

P2P

NACHA proposes that the EPS proposal increases the attractiveness of the ACH system to P2P and mobile payments. This seems unlikely. Consumers and merchants will demand that mobile payments and P2P payments be conducted in "real time" or "near real time." Consumers value real time funds transfers, and anything that could take hours to process, even when expedited, does not qualify. Even if the funds transfer were immediate, it is not clear that consumers are willing to pay a fee except in rare cases. As new business models emerge, same day settlement may find itself in "no man's land" where it is faster than conventional ACH, but not fast enough to satisfy customer needs. For example, it is unlikely that two teenagers will "bump" phones to make a payment and be happy to wait until 5 pm for the transaction to be completed.

Implementation Timeframe

The proposal recommends a very fast track for implementation, voting on the rule in Q1 2012, and making it effective on March 13, 2013. This is too fast. Most financial institutions have already planned for and budgeted for system changes for the next 12 months. The final requirements of this proposal would not be public for several months. If the March 13, 2013 date remains in place, it will increase the expense of implementing the change, making it more likely that RDFIs will not be compliant and that fewer ODFIs would offer the service, two factors that will hurt the new service.

This proposal should be considered a preliminary review of the change with another redrafted proposal be released 2012. This would allow a final change to be issued later in 2012 with an effective date of 24 months after the final rule is effective. The second review period and extended implementation period will allow addressing outstanding issues raised in this proposal and allow banks to integrate system changes into their long term planning, making it more efficient and allowing for more time for testing these changes.

The extended period will also allow more time for banks to survey their commercial and consumer client base to market the new product to generate demand for the service. Relying on existing surveys regarding "same day settlement" to gauge commercial customer interest is not sufficient.

<u>ABA Recommendation</u>

- Evaluate market demand for these services with more accuracy. With more certain volume projections, based on type of payment, banks can make more accurate forecasts regarding returns on investment to determine the proper level of participation by individual banks.

- Determine the effect of this change on banks' other payment products.
- Allow financial institutions a reasonable amount of time to make significant system changes with a minimum of disruption and cost. The higher costs of a 2013 implementation would be a factor when banks determine the return on investment of this initiative.
- Extend the effective date to 24 months following the approval of a final rule.

Conclusion

As noted, the proposal to implement EPS ACH holds great promise. However, all facets of the payments portfolio must be considered before advancing the ACH network in this direction. Ultimately, the proposal must be weighed against the overall effect it will have on each bank. In order to conduct this analysis, banks need more information than currently is available. Then, when that information is available and banks can move forward they will need adequate time to make needed systems changes in an efficient manner that will minimize excess costs. However, until such time, ABA believes the business case has not been made and opposes implementation of the changes as proposed.

Rather, ABA recommends that the proposed effective date of March 2013 be pushed back to no earlier than 24 months after the final rule is approved, if it is approved. This additional time will allow for a more accurate evaluation of market demand for EPS ACH. More detailed projections of transaction volume by payment type would greatly assist banks in determining how to market this new product. This information gathering effort needs to consider how the new EPS ACH product will affect existing bank payment products. Finally, financial institutions are operating under significant financial constraints during this time period. Some of the greatest expenses are related to system changes and upgrades. Most banks have already scheduled their 2012 systems changes and disrupting that schedule will be costly and burdensome. The proposed deadline of March 2013 is not practical. The additional time will allow banks to construct a cost effective system upgrade calendar and mitigate the expenses associated with the change.

ABA appreciates the opportunity comment on NACHA's Expedited Processing and Settlement proposal. If you have any questions about these comments, please contact the undersigned at (202)663-5147 or via email at skenneally@aba.com.

Sincerely,

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