

The Balancing Act of ODFIs and Third Party Sender

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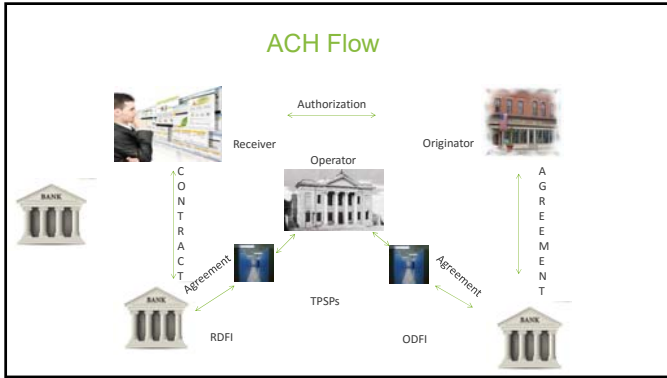


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Agenda

- ACH Overview
- Definitions
- Compliance Topics
- Risk Management
- Third Party Registration and Tool
- Questions

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- ### Definitions
- Receiver-a person that has authorized the originator to initiate a debit, credit or non-monetary entry to their account at an RDFI- *for debits term receiver means all persons signatures required for withdrawal on the account
 - RDFI- a participating depository FI with respect to entries it receives from the Operator for their account holders
 - ODFI- a participating depository FI that transmits entries directly or indirectly to an Operator for transmittal to an RDFI
 - TPSP- an organization that performs any functions on behalf of the originator, the ODFI, or the RDFI related to the processing of entries including the creation of a file or acting as a sending or receiving point
 - Originator-a person that has authorized an ODFI (directly or through a *third party sender*) to transmit, **for the account of that person** an entry to an account at an RDFI

- ### 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 Third Party Sender (Nested). A Third Party Sender must have an Origination Agreement with the ODFI of the Entry. **A Third-Party Sender is never the originator for the 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.

Formatting

- Company Name field- must contain the name of the originator of the transaction
 - Originator is further defined as the party which has been given authorization from the receiver to debit their account at an RDFI

How do we spot a Third Party Sender

- 3 Chances
 - During the initial approval process
 - During the on-boarding or testing process
 - During routine originator reviews

Initial Approval Process

- Questions on the originator application
- Review of the type of business
 - Payroll Processor
 - Accounting Firm
 - Law firm
 - Merchant Service Company
 - Property Management Company
 - Billing Companies
- Review of previous activity if accessible

During the On-boarding or Testing Process

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

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During Routine Originator Reviews

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

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What are the bank's obligations?

- Agreements
- Exposure limits
- Identification of originators
- Compliance with all applicable laws
- Registration

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Agreements for the ODFI

Bank is not required by NACHA Rules to have agreements with other types of service providers (On line Banker Providers unless they are a designated sending point) Vendor Mgmt. Policy should cover the bank's requirements for agreement

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What is Covered in the Agreement?

- ODFI-Operator- agreement to comply with FED Operating Circular 4 and the NACHA Operating Rules
- ODFI-TPSPs
 - Rights and Responsibilities of each party
 - * Vendor management policy should further define contract expectations
- ODFI-Originator
 - Right to Audit
 - Right to terminate
 - Restrictions on activity
 - Compliance with NACHA Rules and U.S. Law
- ODFI-Third Party Sender
 - Requirement that the third party sender enters into an agreement with each of their originators prior to submitting entries

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Exposure Limits

- Must be established for each third party sender
 - Ensuring on-boarding procedures capture the requirement
- Must be reviewed periodically
 - Ensure credit or ACH Policy addresses timing and frequency of the review
 - Ensure procedures are established to ensure policy statements are met
 - Operations should be providing reports or information related to transaction history as part of the review
- Must be reviewed across multiple settlement dates
 - Manual or automated

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Identification of Originators (Stranger Danger)

- Rules provide the ability for the ODFI to request information from the Third Party Sender about any originator they are doing business with
- Third Party Sender has to provide information within 2 banking days of the request
 - NACHA Rules are minimum requirements
 - Bank may impose quicker time frame through agreement

Audits

- Required for all Third Party Senders
- Must be completed by Dec 31st
- Can be internal or external audit
- Documentation must be maintained for 6 years
 - NACHA required audit is simply a review of compliance with ACH Rules
 - Regulator expectations of Third Party Sender reviews is much higher

Compliance with applicable laws and regulations

- REG E
 - Assurance from Third Party Sender that all ACH entries they submit on behalf of their originators are properly authorized
- OFAC
 - Domestic vs. International
- BSA
 - Know your customer and theirs
 - Suspicious activity reporting
- REG GG

FDIC Recommended Controls and ACH Rules

FDIC

- Ensure agreements are in place
- Adopt due diligence policies independent of the Third Party Sender that outline thresholds for unauthorized items and what action FI can take if processor exceeds limits

NACHA Rules

- Require agreements in place with Third Party Senders prior to origination
- NACHA requires that an ODFI with any Third Party Senders with greater than .5% of their items being returned as unauthorized put measures in place to reduce the rate or the Third Party Sender could be suspended

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FDIC Recommended Controls and ACH Rules

FDIC

- Develop an approval process that goes beyond credit risk
- Require merchant processors to provide information related to their clients
- Establish procedures to act promptly to minimize consumer harm including filing SAR reports

NACHA Rules

- An ODFI must perform due diligence with respect to the Third Party Sender sufficient to form a reasonable belief that the Third Party Sender has the capacity to perform its obligations in conformance with these rules
- Third Party Senders must provide client information to the ODFI within 2 business days of a request
- Rules require that all FIs must comply with applicable federal and state laws & regulations

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NACHA Requirement

- 2.2.2 ODFI Risk Management
 - An ODFI must perform due diligence with respect to the Third Party Sender sufficient to form a reasonable belief that the Third Party Sender has the capacity to perform its obligations in conformance with these rules.
 - Assess the nature of the activity and the risk it presents
 - Establish, monitor and review exposure limits
 - Monitor activity
 - Enforce any agreed upon restrictions

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Further Due Diligence

- Who are the primary business partners of the third party sender?
 - Ask
 - Check their website or marketing materials
- What products do their partners typical sell
 - Ask
 - Search internet for reviews or consumer complaints
 - FTC & CFB maintain databases for public access for consumer complaints and enforcement actions

Credit Risk

- Selection
- On-going Monitoring
- Annual review

Selection

- Is this strictly a credit decision?
- Understand that not all Third Party Senders are alike
 - Professional services company vs. payment processor

Law Firms	Payroll Companies
Accounting Firms	Merchant Providers
Property Management	Tuition Processing Companies

Underwriting

- Board approved Credit or ACH Management policy should address the specific requirements for underwriting
 - Type of financial information required
 - Sources used for vetting
 - Credit Reports on principal owners
 - Requirement of the Third Party Sender to provide details of it's selection process and underwriting policy
 - Details on activity
 - Debit vs. Credit
 - Internet/Telephone or in person authorizations
 - Consumer vs. Business

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Exposure Limits

- Policy should define criteria or methodology used in establishing Third Party Sender exposure limits
- Procedures for reviewing
- Procedures for periodic increases or decreases
 - Increases granted by staff with proper lending authority
- Procedures for monitoring across multiple settlement dates
 - Manual or automated
- What are the procedures for the Third Party Sender to add new clients to their business

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Exposure Limits

- Key elements in establishing limits
 - Risk Levels
 - Product
 - Separate limits for debits and credits
 - Aggregating the total exposure limit for both debit and credit transactions
 - Assigning a cushion
 - Measuring across multiple settlement date
 - Allowance for mixed files or not

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Monitoring

- File totals vs. expected totals
- Dollar amounts per entry
- Returns Administrative by originator (File formatting is critical)
 - NSF
 - Account Number issues
 - Closed accounts
 - Stop payments
- Adjustments
 - Unauthorized and Revoked Authorization

Monitoring

- Increases in returns
 - Why?

<ul style="list-style-type: none"> New unformed client Specific client with NSF issues 	<ul style="list-style-type: none"> Rates across the client base rise Significant contact from RDFIs with upset consumers
----------------------------------------------------------------------------------------------------------------	--------------------------------------------------------------------------------------------------------------------------------------------------
- What is the remedy?
 - Anywhere between education and termination
 - Agreements should have immediate termination clause
 - Timing of terminations needs to be planned
- Draft procedures for soliciting information about a specific client of the Third Party Sender

Review

- Annual or as required by the Credit or ACH Management Policy
 - List of reports needed from operations
 - Volumes, return rates, over limit situations
 - Specific information needed for review
 - Credit Reports
 - Check for legal issues for the owners
 - FTC of CFB actions

Annual Audit of the Third Party Sender

- What are you requiring the Third Party Sender to provide as proof of completion?
 - Certification
 - Audit Sheets
 - Audit Report
 - Requirements for follow up on non-compliant finding or operational issues raised during the review
- This should be addressed in the agreement

Fraud Risk

- Data Theft
- Incomplete Transactions
 - Debit or credit
- Products or services not delivered as promised
- Deceptive marketing practices
- Account Take Overs
- Phishing
- Payment scams
- **Nested Third Party Senders**



Mitigation

- Selection
- Monitoring
- Review

Selection

- KYC Policies
 - Who is the third party sender doing business with?
- Ensure selection of Third Party Sender and their clients fits with the risk appetite of the bank
- Procedures for checking legitimate sources
 - O.W.L.
 - T.O.D.

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Review

- Volumes
- Return Rates
- Shifting of volumes to other payment instruments
 - International Wires
 - Remotely Created Checks
 - Prepaid Cards

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Review

- Review of audits or on-site inspections
 - Third Party Sender internal controls
 - Review of security procedures in place to handle ACH data
 - Ensure Third Party Sender compliance with your security procedures
 - How many exceptions were there during a particular period or year?
 - Are the Layers in place according to FFIEC Guidance?
 - Is there an education or information sharing program in place
 - How does this information get past to the client of the Third Party Sender?

Operational Risk

- Hardware failure
- Software failure
- Telecommunications failure
- Power failure
- Human error
- Staffing
- Disaster

Mitigation

- Contingency plan for the FI
 - All aspects of processing including notification to all Third Party Senders that there is a processing issue
- Contingency plan for the Third Party Sender
 - Ensure that files are backed up from clients for reproduction
 - Create notification process with clients
- Education of Third Party Sender staff
 - Requirement to have an AAP?
 - Provide training to the clients of the Third Party Sender?

Review of the Risks

- Third-Party Senders
 - What are they sending?
 - Do they have contracts with the originator?
 - Are they financially sound?
 - Who is ultimately responsible?
 - Who are they really?

Third Party Sender Registration and Tool



Third-Party Sender Registration Overview

- This rule requires every ODFI to either register its Third-Party Sender customer(s) with NACHA, or provide to NACHA a statement that it has no such customers
- The registration process will promote consistent customer due diligence among all ODFIs, and serve as a tool to support NACHA's continuing efforts to maintain ACH Network quality
- This registration model is similar to what is already used with Direct Access Registration. NACHA will provide both Direct Access Registration and Third-Party Sender Registration via a single platform because many ODFIs that have neither Direct Access customers or Third-Party Senders could attest to both at one time

Third-Party Sender Registration FAQ

Q: What will NACHA do with the information?

A: This registry will be a foundational tool for ACH Network risk management and could be helpful in the following scenarios:

- Provide baseline information on Third-Party Senders in the ACH Network
- Identify instances in which a Third-Party Sender uses multiple ODFIs
- Identify instances in which a Third-Party Sender is terminated by one ODFI but is registered by one or more other ODFIs
- Facilitate risk investigations when necessary

Recent Rule changes and communication related to TPS

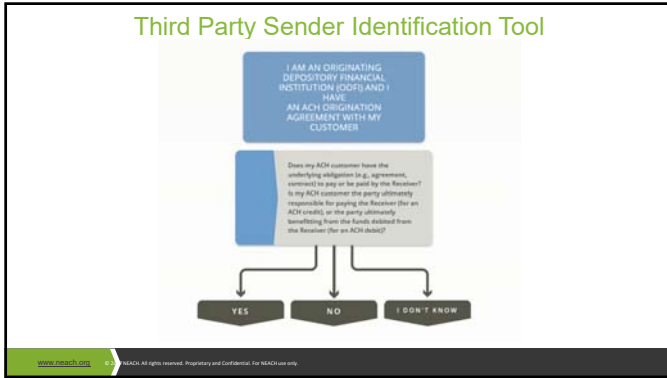
- March 2014 – rule change revised the definition of a Third-Party Sender to help industry participants better understand the fundamental characteristics of the relationships between Third-Party Senders, Originators and ODFIs.
- December 2014 - NACHA released an Operations Bulletin (ACH Operations Bulletin #2-2014: ACH Transactions Involving Third-Party Senders and Other Payments Intermediaries)
 - provided examples to help properly categorize the parties in payment scenarios involving payment intermediaries, many of which are Third-Party Sender relationships
 - served as the basis for a web-based "Third-Party Sender Identification Tool" – see <https://www.nacha.org/third-party-sender-identification-tool>
- January 2015 - rule change became effective that explicitly applied certain ODFI risk management obligations to Third-Party Senders. (Subsection 8.104 "Third-Party Sender," 2016 NACHA Operating Rules)

Third Party Sender Identification Tool

To begin, select the category that describes your organization.

ORIGINATING DEPOSITORY
FINANCIAL INSTITUTION (ODFI)

BUSINESS



- ### Elements of the Third-Party Sender Registration Rule
- Initial Registration
 - Supplemental Information
 - Enforcement
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- ### Initial Registration
- ODFIs with no TPS – simple statement to acknowledge this via the registry
 - Registry will be tied with Direct Access registry
 - ODFIs with TPS – initial basic information provided via registry
 - ODFI's name and contact information
 - name and principal business location of the Third-Party Sender
 - routing number used in ACH transactions originated for the Third-Party Sender (as included in the Originating DFI Identification field)
 - Company Identification(s) of the Third-Party Sender
 - ODFIs will be able to register using an automated, batch upload.
 - single platform for both Third-Party Sender registration and Direct Access registration
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Initial Registration

- ODFI is required to provide the initial registration information within 30 days of originating the first ACH entry for the customer
 - If ODFI becomes aware that an unregistered customer is actually a TPS that should be registered, the Rule provides 10 days for the ODFI to register that customer.
 - For example, an ODFI that learns through its own monitoring that an existing customer is a Third-Party Sender would have 10 days to register the Third-Party Sender from the date it makes such a determination.
 - ODFI also might learn of a Third-Party Sender from NACHA's risk investigations staff, which would notify the ODFI in writing that it has 10 days to register the Third-Party Sender.
- ODFI is required to update the registration information on the TPS within 45 days following any change to the information previously provided, including if the Third-Party Sender relationship is terminated.
 - A period of 45 days balances the need for the registration information to be reasonably current, while enabling ODFIs to submit updates on a regular, routine schedule following the end of a calendar month or similar periodic reporting cycle.

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Initial Registration

- Requirement applies to TPS that are the ODFI's direct customers, as well as those other Third-Party Senders that are direct customers of the first Third-Party Sender, otherwise known as "nested" Third-Party Senders.
 - To aid ODFIs with due diligence regarding nested Third-Party Sender relationships, the Rule requires Third-Party Senders to disclose to their ODFIs any other Third-Party Senders for which they transmit ACH entries.
 - The Rule also obligates Third-Party Senders to provide their ODFIs, upon request, with any registration information needed.
- The obligation to register applies regardless of whether the ODFI allows the Third-Party Sender Direct Access to an ACH Operator.
 - In the case of Direct Access, the ODFI must register the Third-Party Sender with NACHA in addition to registering its Direct Access status.

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Supplemental Registration

Beyond the initial registration information, it may become necessary for NACHA to request and receive additional information about a TPS.

NACHA would request this information regarding risk events, which are cases in which NACHA believes that a TPS poses an escalated risk of:

- (i) financial loss to one or more Participating DFIs, Receivers or Originators,
- (ii) violation of the Rules or Applicable Law, or
- (iii) excessive Returns

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Supplemental Registration

If it becomes necessary for NACHA to receive additional information about a Third-Party Sender, upon receiving a written request from NACHA, an ODFI will be required to provide **within 10 Banking Days** any or all of the following information that is requested:

- any doing-business-as names, taxpayer identification number(s), and street and website address(es) of the Third-Party Sender;
- the name and contact information for the Third-Party Sender's contact person;
- names and titles of the Third-Party Sender's principals;
- the approximate number of Originators for which the Third-Party Sender transmits entries; and
- a statement as to whether the Third-Party Sender transmits debit entries, credit entries or both.

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Enforcement

The existing enforcement approach and procedures that apply to all *NACHA Operating Rules* will be used. This includes:

- Risk investigation and *Rules* enforcement communications always begin with the ODFIs
- ODFIs will have an opportunity to respond, including whether an alleged violation has been remedied
 - NACHA will have authority to sanction and/or fine ODFI for non-compliance. There are no automatic fines. Fines, if at all, occur at the end of the enforcement process.

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Effective Date – September 29, 2017

- This will be the first date the Third-Party Sender registry will be available for ODFIs to begin submitting registration information.
 - Many ODFIs will be focused on going live with Phase 2 of Same Day ACH in the time period leading up to that effective date of September 15, 2017; therefore an effective date for this Rule is after the go-live date for Phase 2 of Same Day ACH.
 - With this effective date, ODFIs will have more than a full year to be ready to register their Third-Party Sender customers.
- NACHA will provide ODFIs with an implementation period to submit initial registration information, or to provide statements that the ODFIs have no Third-Party Sender customers, in order to allow for implementation to be spread out across a reasonable time period.
 - The implementation period will last through March 1, 2018.

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Implementation checklist

ODFI with no Third-Party Senders

- Review current clients to ensure no TPSs
- Submit statement indicating no TPS clients

ODFI with Third-Party Sender clients

- Review current clients to ensure all TPSs are identified
- Ensure all information for an initial registration is available for all identified TPS
- Develop procedures for submitting initial registrations (both for those current TPS customers and new customers after Sept 2017)
- Develop procedures for submitting updates to registered TPS
- Develop procedures to gather information and respond to requests for supplemental registration information

Questions?



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