ACH Warranties and Indemnities

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What is a Warranty?

- war·ran·ty
    - /ˈwôrən(t)ē/
        - a term or promise in a contract, breach of which entitles the innocent party to damages

New TV Comes with
2-Year Warranty!

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What is an Indemnity?

- in·dem·ni·ty
  - /inˈdemnədē/
    - a contractual obligation of one party to compensate the loss incurred by another party due to the relevant acts of the indemnitor or any other party

I'm so sorry!
Here's some money for your trouble!

ODFI Warranties and Indemnities: Authorization

Authorization Warranty

The Entry Is Authorized by the Originator and Receiver

Article Two, Subsection 2.4.1.1

(a) The Entry has been properly authorized by the Originator and the Receiver in accordance with [Nacha Operating] Rules.

(b) The Originator's authorization has not been revoked, the Origination Agreements concerning the Entry have not been terminated, and neither the ODFI, any Third-Party Sender, nor the Originator has actual knowledge of the revocation of the Receiver's authorization or of the termination of the agreement between the RDFI and the Receiver concerning the Entry.
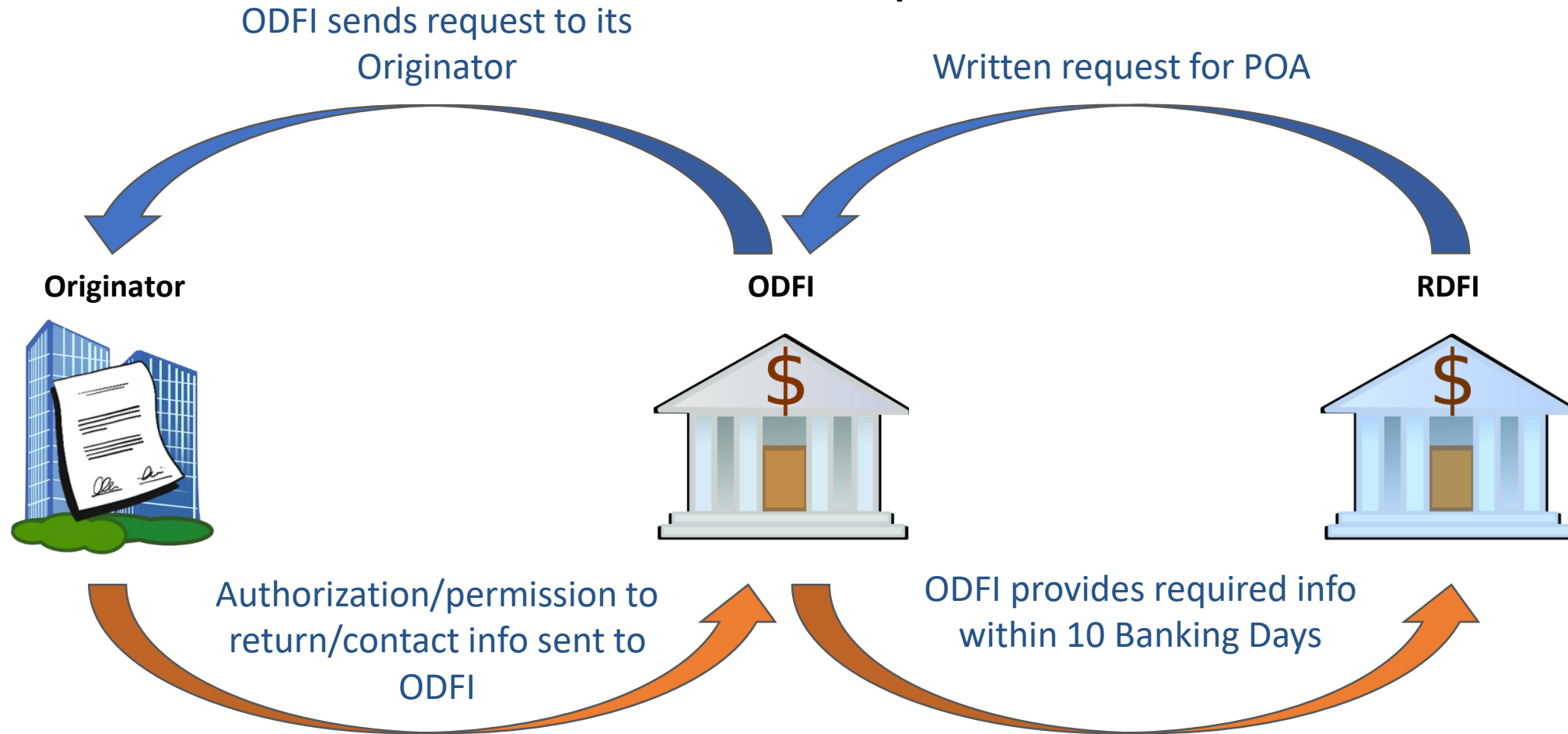
How is a Breach Handled?

Within 60 Calendar Days?	• Obtain a Written Statement of Unauthorized Debit • Process an Extended Return Entry (e.g. R05, R07, R10, R11, etc.) • Life is good – RDFI and Receiver are happy!
Outside 60 Calendar Days?	• Sigh and wonder why the Receiver didn't report the issue timely • Buckle in for some fun

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Proof of Authorization Request

ODFI sends request to its Originator

Written request for POA

Originator

ODFI

RDFI

Authorization/permission to return/contact info sent to ODFI

ODFI provides required info within 10 Banking Days

Contacting an ODFI

FIELD	1	2	3	4	5	6	7	8	9	10	11
DATA ELEMENT NAME	RECORD TYPE CODE	TRANSACTION CODE	RECEIVING DFI IDENTIFICATION	CHECK DIGIT	DFI ACCOUNT NUMBER	AMOUNT	INDIVIDUAL IDENTIFICATION NUMBER	INDIVIDUAL NAME	DISCRETIONARY DATA	ADDENDA RECORD INDICATOR	TRACE NUMBER
Field Inclusion Requirement	M	M	M	M	R	M	O	R	O	M	M
Contents	'6'	Numeric	TTTTAAAA	Numeric	Alphameric	$$$$$$$$ ¢¢	Alphameric	Alphameric	Alphameric	Numeric	Numeric
Length	1	2	8	1	17	10	15	22	2	1	15
Position	01-01	02-03	04-11	12-12	13-29	30-39	40-54	55-76	77-78	79-79	80-94

- First 8 digits of the Trace Number represent the ODFI of the Entry
  - Use **Nacha's ACH Contact Registry** to find contact information

Welcome Back!

Please login to your **Portal** account.

Email

Password

Forgot Password ?

I'm not a robot
reCAPTCHA
Privacy - Terms

Login

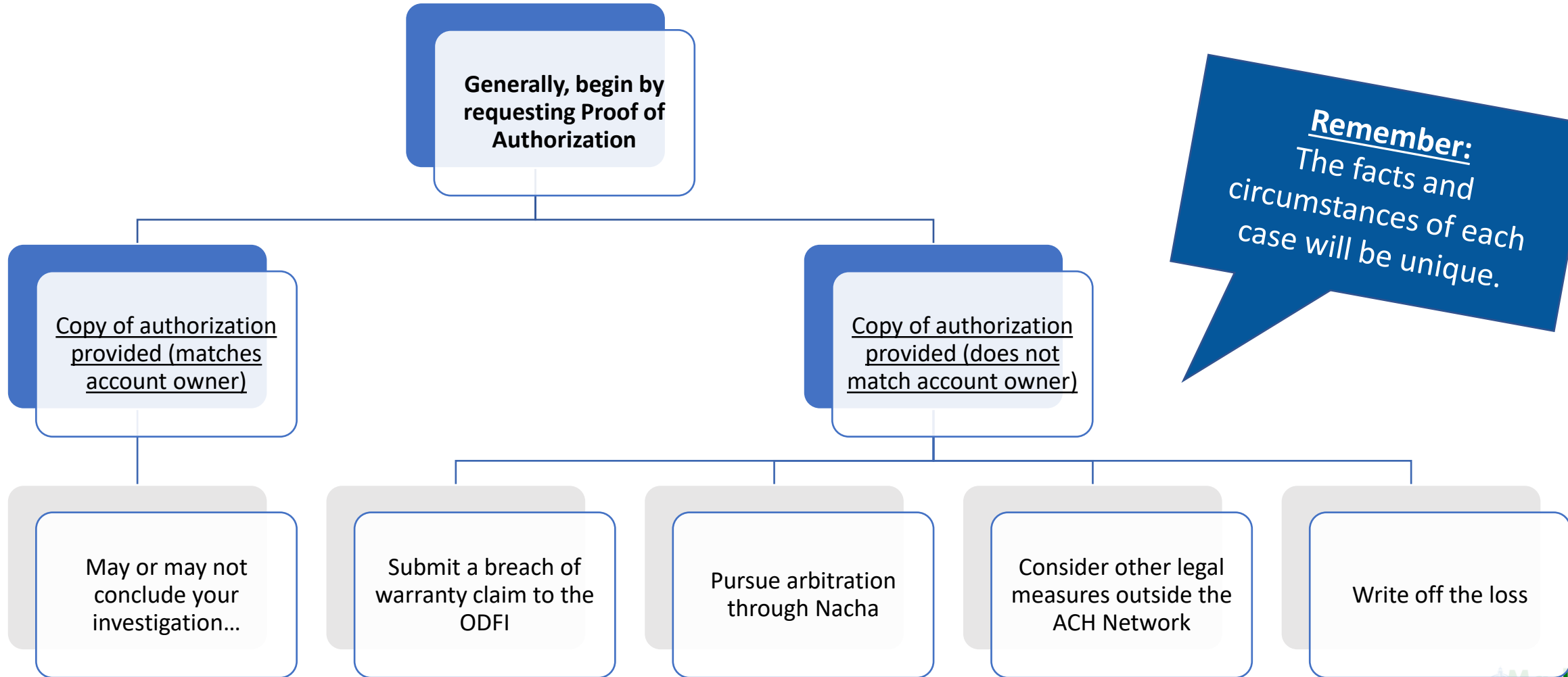# Proof of Authorization Response

For Consumer Entries…

- ODFI must provide:
  - Copy of the authorization; **or**
  - Permission for the RDFI to return the Entry in lieu of providing the authorization*

- The ODFI must provide to the RDFI a copy of the authorization, permission to return, or contact information (when applicable) within 10 Banking Days of the RDFI's written request

For Non-Consumer Entries…

- ODFI must provide:
  - Copy of the authorization; **or**
  - Permission for the RDFI to return the Entry in lieu of providing the authorization*; **or**
  - The name and phone number or email address for the Originator

How is a Breach Handled?

Generally, begin by requesting Proof of Authorization

Copy of authorization provided (matches account owner)

Copy of authorization provided (does not match account owner)

Remember: The facts and circumstances of each case will be unique.

May or may not conclude your investigation…

Submit a breach of warranty claim to the ODFI

Pursue arbitration through Nacha

Consider other legal measures outside the ACH Network

Write off the loss

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How Do We Assert Breach of Warranty?

- No official process described in the Rules
- Could begin with a...
  - Phone call
  - Email
  - Fax
  - Written letter via snail mail

Best Practice

- Put the claim in writing and send via ODFI's preferred channel for submission

Sample Breach of Warranty Claim

[DATE]

[ODFI NAME]

ATTN: ACH Investigations

RE: Breach of Warranty Claim – Unauthorized Entry

[Entry Information]

[Asserted Breach of Warranty Claim Details]

[Resolution of this Investigation, Next Steps]

[ODFI Response Options]

[Name, Title, Signature]

[Enclosure – WSUD]

Indemnity by ODFI

Who is Indemnified?

- Every RDFI and ACH Operator

What are they Indemnified Against?

- All claims, demands, losses, liabilities, and expenses, including attorneys' fees and costs, that result directly or indirectly from:
  - (a) the breach of any warranty made to such party by the ODFI under these Rules

RDFI Warranties and Indemnities: Notifications of Change

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NOC Warranty

RDFI Warranties for Notifications of Change

Article Three, Subsection 3.9.3

... an RDFI that transmits a COR Entry, including a corrected COR Entry, warrants to each ODFI and ACH Operator that the information contained within the Corrected Data field of a COR Entry or corrected COR Entry is correct.

The RDFI's warranty supersedes and renders inoperative any similar warranty (but not any other warranty) of the ODFI contained within Subsection 2.4.1 (General ODFI Warranties).

What Could Go Wrong?

ODFI Transmits Entry to Acct 123456 at RDFI

RDFI Sends C01 to ODFI; Corrected Acct 12345

ODFI

RDFI

ODFI Provides C01 to Originator w/in 2 Banking Days

Originator Updates Acct and Transmits Addt'l Entries

ODFI

Originator

What Could Go Wrong? (cont.)

ODFI Transmits Entry to Acct 12345 at RDFI

ODFI

RDFI

- RDFI gets a phone call from the owner of account 12345 claiming they never authorized this Entry (these Entries)
- RDFI now begins to panic, realizing they provided an incorrect NOC

Uncovering the Error

- Error is often discovered after the Receiver completes a WSUD

- ACH Operations realizes no such Entry to that account number was received, but instead it was corrected and posted

Sample Written Statement of Unauthorized ACH Debit (WSUD)

Section I – Account /Transaction Information

Receiver's Name: _____

Receiver's Account Number: _____

Date(s) and Amount(s) of Debit(s) – Listed sequentially in date order: _____
_____
_____

Originator/Company (Party Debiting Account): _____

      NOTE: This form can only be used for one specific Originator/Company (Not Multiple Originators)

*Intended Third-Party Payee (if different from Debiting Party above): _____

Section II – Receiver Assertion

I (the undersigned) hereby attest that I have reviewed the circumstances of the above electronic (ACH) debit(s) to my account and determined that the debit(s) were not authorized by me, or the Entry(s) do not conform to the terms of my authorization, and the following (identified with checkmarks) are the reason(s) for the Entry(s) being defined to the best of my ability as unauthorized:

☐ I did not authorize _____ (Company Name) to originate the ACH Entry(ies) described herein from my account. **(Consumer SEC Codes ONLY)**

☐ I Authorized _____ (Company Name) to originate one or more ACH Entries to debit funds from my account, but: **(Consumer SEC Codes ONLY)**

    ☐ Amount debited is different than what I authorized. Amount I authorized was $_____, or;

    ☐ The debit was made to my account on a date earlier than the date on which I authorized. I authorized the debit to be made to my account on (or no earlier than) _____, 20___.

    ☐ *The Company debiting my account failed to make or complete the corresponding payment to the intended Third-Party Payee.

    ☐ Other (specify)_____.

☐ Authorization Revoked – I authorized _____ (Company Name) to originate one or more ACH Entries to debit funds from my account, but on _____, 20___ I revoked that authorization by notifying _____ (Company Name) in the manner specified in the original authorization with that company. **(IAT, PPD, TEL, & WEB ONLY)**

☐ Required notice not provided in accordance with requirements of ACH Rules **[ARC, BOC, POP]**

☐ Signature is not authentic or authorized, and/or the item has been altered **[ARC, BOC, POP]**

☐ Amount of Entry was not accurately obtained from the source document **[ARC, BOC, POP]**

☐ Source document is improper to be initiated as an ACH Entry **[ARC, BOC, POP]**

☐ Improper Reversal Entry

Now What Happens?

Can't the RDFI just return the Entry as unauthorized if it has a completed WSUD?

- Article Three, Subsection 3.13.1 states, "An **RDFI may Transmit an Extended Return Entry** with respect to any debit Entry for which it recredits a Receiver's account in accordance with Section 3.11 (RDFI Obligation to Recredit Receiver), **provided that**: (a) **no error was made by the RDFI in the debiting of the original Entry to the Receiver's account**…"

Remember the Warranty…

In accordance with Article Three, Subsection 3.9.3, the **RDFI warranted (i.e. promised) to the ODFI** that the corrected information was indeed correct

Furthermore, in accordance with Article Three, Subsection 3.9.4, the **RDFI indemnified the ODFI** from and against all claims, demands, losses, liabilities, or expenses that result from a breach of warranty

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How is a Breach Handled?

An Originator who receives an unauthorized return after making changes based upon corrected data in a NOC is unlikely to be happy

ODFI may assert breach of warranty against the RDFI

Therefore, they will likely press their ODFI for recourse

RDFI has agreed to indemnify the ODFI

Indemnity by the RDFI

Who is Indemnified?

- Every ODFI and ACH Operator

What are they Indemnified Against?

- All claims, demands, losses, liabilities, or expenses, including attorneys' fees and costs that result directly or indirectly from any breach of the warranties contained in Subsection 3.9.3 (RDFI Warranties for Notifications of Change)

Why Even Send NOCs?

- Benefits to NOCs
    - Provide corrected data back to Originator securely and efficiently without having to inconvenience the Receiver
    - Avoid continued, ongoing exception processing

> Hooray, my ACH transactions will continue posting!

Risk Controls for NOCs

- Require dual-control when processing NOCs (mitigate risk of insider fraud)
  - One person keys
  - Another person verifies the corrected data
- Establish a policy/procedure that indicates when you will and will not send a NOC

ODFI Warranties and Indemnities: Converted Check Entries

No "Double Debit" Warranty

ARC and BOC

The Eligible Source Document used to initiate the [ARC or BOC] Entry will not be presented or returned such that any Person will be required to make payment based on the Eligible Source Document, unless the [ARC or BOC] Entry is returned by the RDFI.
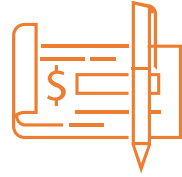
POP

The Eligible Source Document used to initiate the POP Entry has not been provided by the Receiver for use in initiating any prior POP Entry.
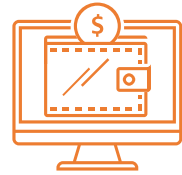
What Could Go Wrong?

Deposits Check #1234 for $1,000 on 3/1

BOFD

PAYING BANK

ACH ARC Entry Check #1234 for $1,000 on 4/4

ODFI

RDFI

Payee's financial institution has now paid the same check **twice**!

How is the Error Discovered?

Financial institution may detect the error based on reporting/data analytics	• Return ACH Entry R39 (Source Document Presented for Payment) within two Banking Days
What if the Receiver is the one who discovers the error?	• It depends…

How to Resolve…

Within Time Frame for Extended Return

- Obtain a Written Statement of Unauthorized Debit
- Process an Extended Return Entry using the R37 (Source Document Presented for Payment) return reason code

Outside Time Frame for Extended Return

- Most likely outside time frame to return physical check
- Beyond the 60-day time frame for ACH Extended Return
- … the breach of warranty claim is back!

Breach of Warranty Claim

- Generally, assert breach of warranty on the ACH debit (regardless of whether the paper check or ACH was paid first)
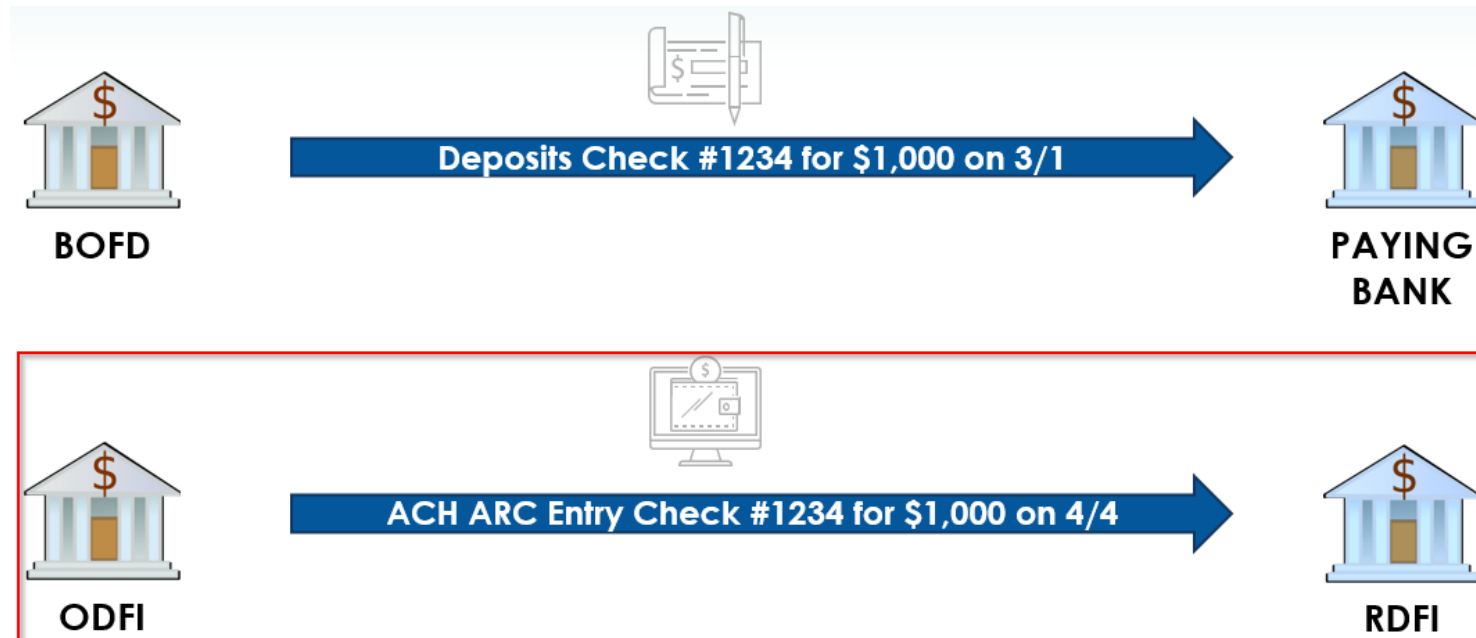
How Do We Assert Breach of Warranty?

- No official process described in the Rules
- Could begin with a...
  - Phone call
  - Email
  - Fax
  - Written letter via snail mail

Best Practice

- Put the claim in writing and send via ODFI's preferred channel for submission

Sample Breach of Warranty Claim

[DATE]

[ODFI NAME]

ATTN: ACH Investigations

RE: Breach of Warranty Claim – ACH Entry and Source Document Paid

[Entry Information]

[Asserted Breach of Warranty Claim Details]

[Resolution of this Investigation, Next Steps]

[ODFI Response Options]

[Name, Title, Signature]

[Enclosure – Photocopy of Paid Item]

Indemnity by ODFI

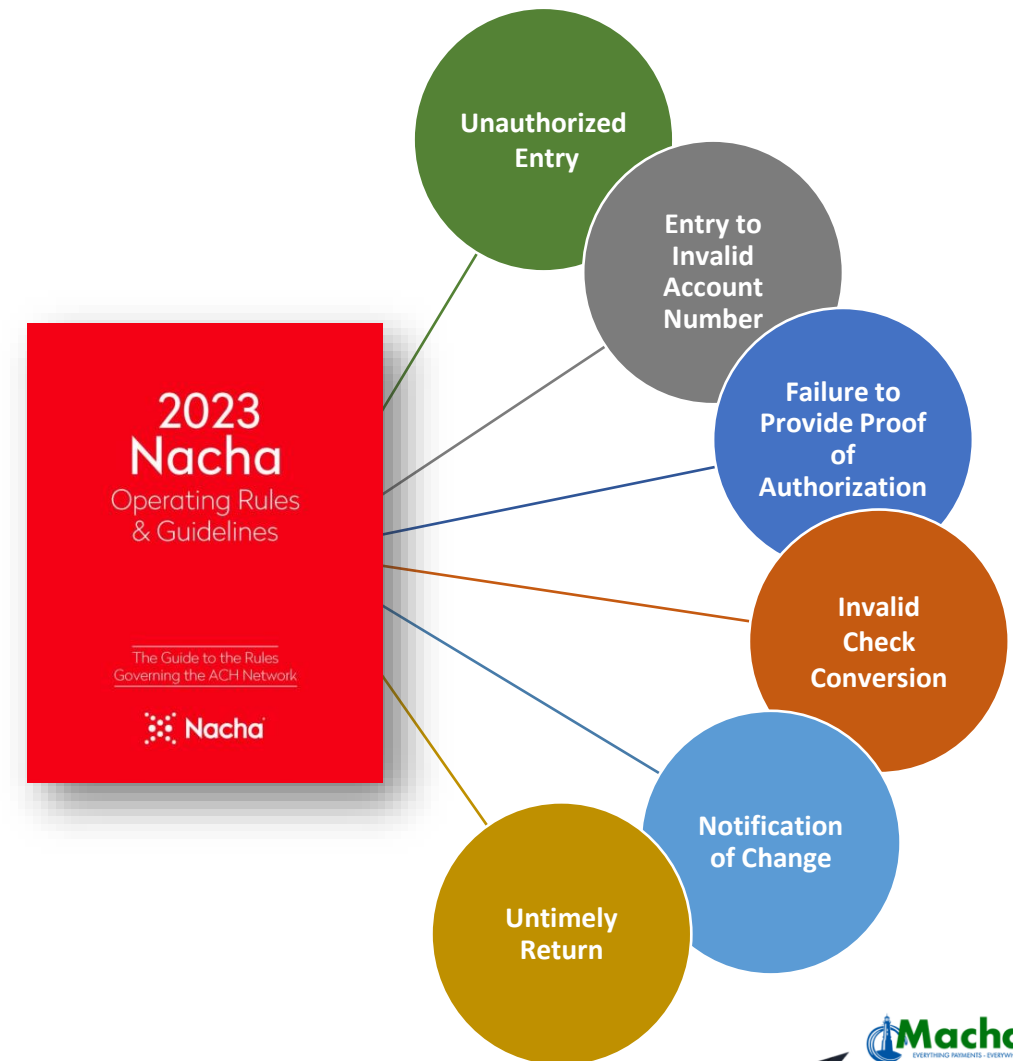## Who is Indemnified?

- Every RDFI and ACH Operator

What are they Indemnified Against?

- All claims, demands, losses, liabilities, and expenses, including attorneys' fees and costs, that result directly or indirectly from:
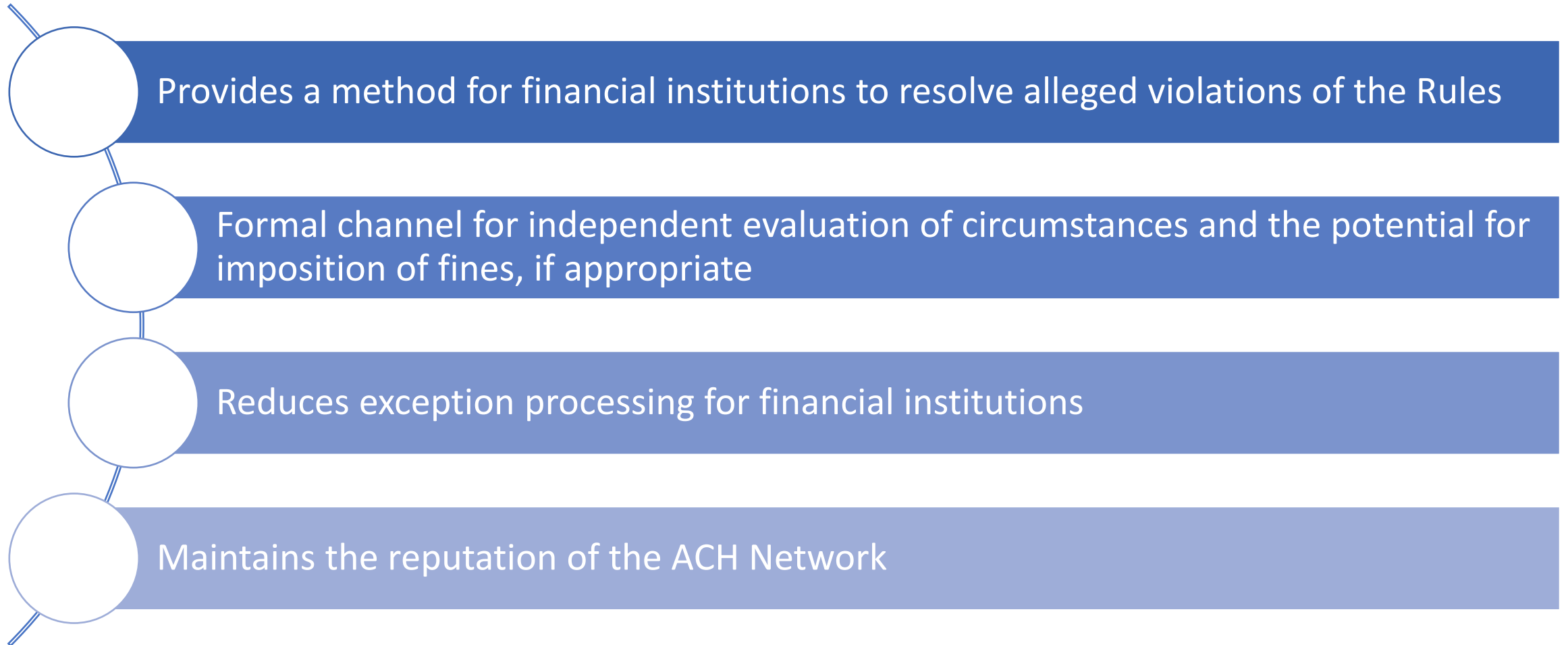 - (a) the breach of any warranty made to such party by the ODFI under these Rules

When the Breach of Warranty Claim Process Does Not Resolve the Issue
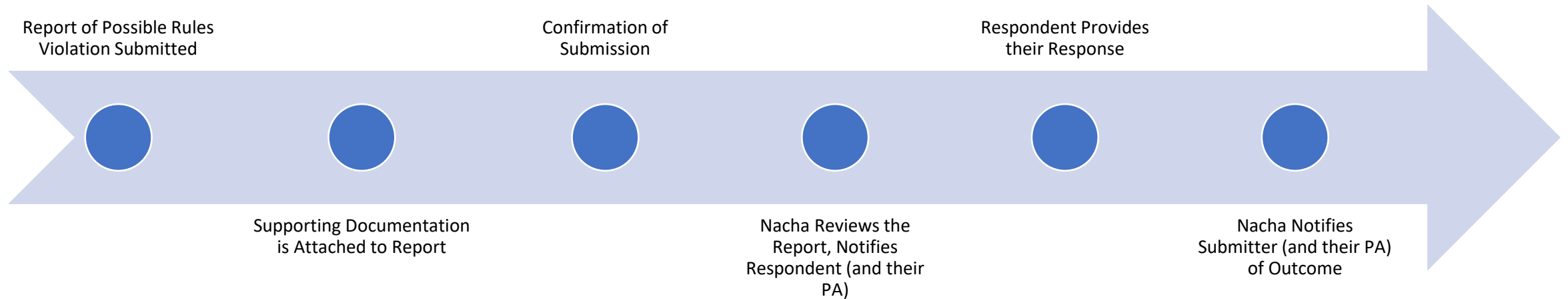
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System of Fines

- The **National System of Fines** is the enforcement mechanism for the ACH Network

- Any violation of the Rules can be submitted

- Fines *may* be assessed and can range from $0 - $500,000 (per month)

System of Fines, Benefits

Provides a method for financial institutions to resolve alleged violations of the Rules

Formal channel for independent evaluation of circumstances and the potential for imposition of fines, if appropriate

Reduces exception processing for financial institutions

Maintains the reputation of the ACH Network

System of Fines Overview

Report of Possible Rules
Violation Submitted

Confirmation of
Submission

Respondent Provides
their Response

Supporting Documentation
is Attached to Report

Nacha Reviews the
Report, Notifies
Respondent (and their
PA)

Nacha Notifies
Submitter (and their PA)
of Outcome

How to Submit a Violation

Easiest (and preferred) method: Submit online

- nacha.org/violation

Need support?

- **Email**: Nacha-Ntwrk-Compliance@nacha.org
- **Phone**: (703) 561-1100
- Reach out to UMACHA

Arbitration

Method for resolution of disputes between financial institutions regarding alleged violations of the Rules

- Contrast with Report of Possible Rules Violation

Who can file?

- Any Depository Financial Institution

What are the benefits?

- Expeditious process; start to finish is about three months
- Alternative to litigation via the courts (which can be costly and take much longer)
- Arbitration is (sometimes) mandatory

Arbitration

Who arbitrates the case?

- ACH payments experts, including bankers, lawyers and Payments Association members
- Number of arbitrators is dependent on the damages claimed:
  - $250 - $10,000 = One arbitrator
  - $10,000 - $50,000 = Three arbitrators
  - >$50,000 = Three arbitrators

How to File Arbitration Claim

Submit claim to Nacha within two years of the alleged violation of the Rules

Pay $250 filing fee

Email **Nacha-Ntwrk-Compliance@nacha.org** to arrange payment of filing fee and begin the arbitration process

- **Warranty**: A term or promise in a contract, breach of which entitles the innocent party to damages

- **Indemnity**: A contractual obligation of one party to compensate the loss incurred by another party due to the relevant acts of the indemnitor or any other party

- ODFIs and RDFIs make various **warranties** and **indemnities** when processing ACH Entries, and it's important to understand them to **control and mitigate risk**

Questions?

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