UCC 4A PRIMER

What you need to know, and how it affects your financial institution.

What is the UCC?

The Uniform Commercial Code (UCC) is a comprehensive body of state law governing commercial transactions, including sales of goods, commercial paper, bank deposits and collections, letters of credit, bulk transfers, warehouse receipts, bills of lading, and investment securities and secured transactions. Prior to the development of the UCC, the law applicable to commercial transactions differed widely from state to state. The UCC was conceived to create modern uniform commercial law, which could be adopted by all the states.

How are UCC 4A and ACH Connected?

Article 4A covers certain funds transfers, including Automated Clearing House (ACH) credit transactions not subject to the Electronic Funds Transfer Act (EFT), from which Regulation E evolved. Article 4A has now been adopted by all 50 states and the District of Columbia.

How will UCC 4A affect my institution?

Article 4A was designed to place liability and set standards for the handling of commercial credit transactions. The article specifically deals with the acceptance of transactions, liability for unauthorized or erroneous entries, returns, cancellations or amendment of payment orders, notices of payment, and “commercially reasonable” security procedures.

ACH Rules regarding UCC 4A

Provisionality –

Under UCC 4A, payment by an RDFI to a Receiver is final. This normally occurs when the funds are made available to the Receiver by the RDFI. Also, UCC 4A will not allow an RDFI to return a payment once it has been “accepted”. Acceptance is defined as either when funds are made available to the receiver or when the receiving financial institution receives final settlement from the ACH Operator, whichever is earlier. Returns after “acceptance” are only valid if the receiver does not have an account with the receiving financial institution, the receiver’s account is closed, or the financial institution is prohibited by law from receiving credits for the receiver’s account.

UCC 4A does allow an RDFI to obtain reimbursement from the Receiver, if a transaction does <u>not</u> settle, which makes payment provisional until the RDFI obtains settlement from the settlement agent (the Fed). It also requires both the Originator and Receiver to be made aware of this rule and for the Receiver to agree to be bound by it.

Notice to Receiver –

Under UCC 4A, the RDFI has to notify the Receiver that a credit has been received by midnight of the business day following the settlement date. If this requirement is not met, the RDFI may owe interest on the entry from the time the notice should have been given to the time it was given.

4A allows this requirement to be altered either by specific agreement or a payment system (NACHA) rule change. NACHA has passed a rule change altering this requirement and allowing the RDFI to not give notice when an ACH transaction is received. However, the Receiver must be notified of the rule in order for it to be effective.

ACH as Agent of the ODFI –
An ACH Operator (other than the Federal Reserve Bank ACH) is considered the agent of the ODFI, under 4A. Therefore, if the ACH operator made an error, the RDFI would have recourse against the ODFI.

The ACH Rules override this and bring liabilities in line with those rights the RDFI has when the Federal Reserve Bank processes transactions. The ACH operator and/or Association would be the responsible party if negligent.

Commercially Reasonable Security –
A key provision of UCC 4A, not addressed directly in the ACH Rules deals with "commercially reasonable" security procedures between the parties of a transaction. These are designed to set liability for fraudulent or improper entries. Although the Article does not define "commercially reasonable" security procedures it does give some guidelines. For instance, a signature on a transmittal, by itself, is not considered commercially reasonable. Other considerations for determining what is reasonable include: 1) the wishes of the originating company, 2) generally used security procedures, 3) your relationship with the company and 4) what options you have available.

Notice to Receivers –
Financial institutions must provide a notice once during the life on an account that received commercial credit ACH entries. This notice must include the following:
Provisional Payment to Receivers – RDFI's must disclose to their receivers when payments will be final related to their ACH Commercial credits. Payments should be provisional until final settlement is received from the ACH Operator. If provisional credit is given to the receiver but the ACH Operator reverses the payment due to the insolvency of the originating financial institution, the receiving financial institution will be entitled to refund from the receiver.
Notice of Receipt to Receivers – Under UCC 4A, receiving financial institutions are responsible to notify receivers of their ACH commercial credits before midnight of the next banking day following settlement. The ACH Rules provide the means to eliminate this obligation of the receiving financial institutions by disclosing to the receivers that notice will not be given by the next banking day following settlement.
Choice of Law – The Uniform Commercial Code Article 4A provides rules for determining which state's law applies for interstate disputes concerning ACH transactions subject to Article 4A. If the parties do not agree that laws of a particular state will apply, NACHA Operating Rules require that New York version apply.

For Sample Notice to Receivers Disclosures see "Sample UCC 4A Disclosures"

For more information, refer to your ACH Rule book, Article Two and the "Revised Uniform Commercial Code Article 4A and the Automated Clearing House Network" book.