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Enhancements to Federal Reserve Bank Same-Day ACH Service, Request for Comments

Docket No. OP-1515

Submitted by

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United Bankshares, Inc. (UBSI), with dual headquarters in Washington, DC and Charleston, WV, is a bank holding company with 130 full service banking offices in West Virginia, Virginia, Maryland, Ohio, Pennsylvania, and Washington, D.C. and total assets of $12.1 billion. UBSI holds state bank charters in the name of United Bank in both West Virginia (0519-0039-5) and Virginia (0560-0444-5).

United Bank appreciates the opportunity to respond to the Federal Reserve's Request for Comments on Same-Day ACH Services. To that end, we offer the following responses to the questions posed in the RFC. Please direct any questions or comments to the submitter.

[T]he Board requests comment on the Reserve Banks' adoption of an enhanced same-day ACH service with mandatory participation of RDFIs and an interbank fee by incorporating NACHA's amended operating rules into the Reserve Banks' Operating Circular 4 governing their ACH service.

United Bank shares the Federal Reserve's general observations on the usefulness of Same-Day ACH services and the necessity of ubiquity. Having said that, there are some issues that the FRB should consider before integrating NACHA's recently approved Operating Rules for Same-Day ACH Payments into Operating Circular 4 (OC 4).

- Will Reserve Banks be willing and able to enforce same day acceptance and posting of ACH items delivered via FedLine ACH? Paragraph 7.2 of OC 4 states the following (emphasis added):

  > *A receiving bank must manage its electronic connection so as to permit it to receive items in a timely manner throughout the day.* ***A receiving bank that does not receive items in a timely manner because it fails to so manage its electronic connection*** *or because of emergency circumstances beyond the control of a Reserve Bank is required to settle for the items with a Reserve Bank on the settlement date, but* ***is not considered to receive the items for purposes of the deadline for return if the items are available timely for electronic***

> ***transmission by a Reserve Bank to the receiving bank or for pickup at a Reserve Bank by the receiving bank.*** *The receiving bank may choose next day debit with an explicit charge for float in lieu of settling on the settlement date for debit items.*

This language is problematic when compared to the objectives of Same-Day ACH processing. FedLine ACH RDFIs are technically required to receive only one file per day, and some smaller FIs do that in the morning at or near the opening of business. While such banks could back-date ACH credits received under Phase I rules, they would also have to make interest adjustments if Same-Day ACH credits were made to interest bearing accounts and address any overdrafts that would have otherwise been avoided had the Same-Day ACH credit been posted on time. With the implementation of Phase III of the Same-Day ACH Rules, it appears that any bank taking one file per day and back-dating the items would be in violation of the rules requiring availability by the end of the business day. With this in mind, all RDFIs should be required to take at least two files per day in conjunction with the implementation of Phase III of the Same-Day ACH Rules in order to demonstrate that they have attempted to comply with them. During Phases I and II, Federal Reserve representatives should be actively engaging with those FIs receiving one file per day to educate them on their obligations under the Same-Day ACH rules. Furthermore, other than an emergency situation, RDFIs that elect to not act upon files that are available should not be given an exemption from return item deadlines. The opportunity for ODFIs to receive accelerated return item information is one of the benefits associated with Same-Day ACH processing, but that benefit will not be available if RDFIs are exempted from the timely processing requirement.

- There is some inconsistency between NACHA's rules for Same-Day ACH processing and the approach normally undertaken by the Federal Reserve with respect to timing and deadlines. NACHA has characterized Same-Day ACH funds availability requirements as based on "local time" although "local time" is not a defined term in the NACHA Rules. Is "local time" a function of where the branch is located at which the Receiver banks, where the bank is headquartered, or where the work is processed? FRB rules generally avoid such problems and promote a uniform playing field by establishing a uniform national deadline (See OC 4, Paragraphs 1.3 and 1.3). Based on the way ACH work is currently processed by the Federal Reserve in its role as the ACH Operator and the way the new NACHA Same-Day ACH Rules are written, Same-Day ACH items will be available to RDFIs for posting at the same time nationally, but a financial institution on the West Coast might have three more hours to complete its processing in compliance with the NACHA Operating Rules than would be available to similar financial institution on the East Coast. Inasmuch as Reserve Banks have traditionally worked to maintain a level playing field for all FIs, this may be worthy of additional consideration before adopting the new Same-Day ACH Rules as part of OC 4.

- How will the introduction of multiple deadlines within a Banking Day impact the FRB's risk management services? FedACH Risk Origination Monitoring today is built around a single deadline of 2:15 a.m. at which time the “End of Day Default” rules are employed. Will there be more than one set of End of Day Default rules? In other words, will a batch of Same-Day ACH items that has been suspended due to a credit cap issue require a special set of rules when a Same-Day deadline is reached? Should that batch be rejected immediately following the Same-Day ACH deadline (so those items could potentially be sent as wire transfers) or be held until 2:15 a.m. before being processed under the default rules, knowing that the best available service at that time would be next day availability? Similarly, if a standard batch of work is held due to a credit cap issue, would the default rules accelerate that batch to Same-Day ACH status, with the associated premiums, or would it remain a standard ACH batch and be delivered one day later?

There may be a similar challenge with FRB information reporting services described in Appendix F of OC 4, particularly those set up for scheduled distribution. Will those schedules need to change to accommodate the additional deadlines introduced by NACHA’s Same-Day ACH rules?

The Board requests comment on making receipt of same-day ACH transactions mandatory for all RDFIs. If commenters believe that participation by RDFIs should not be mandatory, the Board requests comment on why the Reserve Banks’ same-day ACH service should remain optional and whether there are non-mandatory alternatives to achieving ubiquity.
United Bank agrees that participation by all Receiving Depository Financial Institutions is necessary if the network is to realize the projected benefits intended of Same-Day ACH.

The Board requests comment on whether the interbank fee included in NACHA’s amended operating rules equitably reapportions the initial implementation costs and ongoing operating costs between ODFIs and RDFIs.
United Bank strongly disagrees with the changes made to the interbank fee in the final rule. In the original proposal, according to the estimates of NACHA’s independent economic consultant, the average RDFI could expect a return on its initial investment of 11.5 years. There are multiple problems with this assessment, and all of them seem to penalize smaller RDFIs. The initial cost estimates were based on a survey done in March 2014, arguably well before the implications of the proposed Same-Day ACH rules were widely understood. This also happened with early surveys on the International ACH Transaction (IAT) rules changes that were also done before the full implication of the rules were understood. Most, if not all, industry observers would agree that IAT costs were understated and IAT volumes were over-estimated. It is likely that the same thing happened here which would translate into a much longer return on investment than 11.5 years. With a reduction in that fee of 36.6% (from $0.082 to $0.052), it will now take 15.7 years to earn income from this program equivalent to the original proposal which makes it significantly less attractive to RDFIs.

The mix of respondents to the survey left smaller financial institutions woefully under-represented in the final results. Using data supplied by NACHA, F responses were broken down into the categories shown on the table below. FIs with assets greater than $100B were well represented while almost every other asset tranche was non-existent. If fairness to NACHA, eight of thirteen Regional Payment Associations (RPAs) did submit responses on behalf of their respective members, but there is no evidence that these RPA responses were weighted more heavily in NACHA's analysis even though they collectively represented thousands of financial institutions.

Analysis of Same-Day ACH Responses					
Asset Range	**FDIC Insured Institutions***	**Credit Unions***	**Total FIs**	**# of Respondents**	**% Responding**
< $250MM	3,891	5,598	9,489	34	0.36%
$250MM - $1B	1,850	571	2,421	39	1.61%
$1B - $100B	658	229	887	51	5.75%
>$100B	23	0	23	17	73.91%
Totals	6,422	6,398	12,820	141	1.10%

**Source: FDIC data as of April 16, 2015 and CUNA's US Credit Union Profile as of 12/31/14*

Even if we were to accept that the survey generated valid results, an 11.5 year cost recovery is not an acceptable return on investment for any business or financial institution. The interbank fee should have been set in a manner that would have allowed recovery in five to eight years which would bring this project more in line with other infrastructure investments that banks make from time to time.

Finally, while the flat-rate transfer process outlined by NACHA in its presentation materials is certainly the simplest to administer, its fairness to RDFIs is dubious. Implementation costs for Same-Day ACH are very much front-loaded rather than evenly distributed (i.e., most of the cost is incurred to receive the first Same-Day ACH item with subsequent items having a relatively low incremental cost). If we assume that the percentage of ACH activity received by the Top 30 remains constant (52.4% using NACHA's 2014 data), the roughly 12,000 insured financial institutions outside the Top 30 would be processing an estimated 17.6 million items in year one using NACHA's year one estimates (37 million x 47.6%). For an "average" bank (outside the Top 30), this would equate to a little under 1,500 Same-Day ACH payments in year one and $76.34 in Interbank Fees [(37 million items x 47.6% x$.052)/12,000]. Meanwhile, Bank of America, the largest RDFI in 2014, would get over $187,000 in Interbank Fees in year one (assuming it continues to receive 9.74% of total ACH activity as it did in 2014). By year five of the model, the average bank outside the Top 30 would be receiving just over $2,000/year (994 million items x 47.6% x $.052/12,000 FIs) while B of A would get more than $5 million, *ceteris paribus*. This whole program appears to widen the gap between the "haves" and the "have nots" in ACH processing and is the antithesis of a healthy payment system.

As was proposed to NACHA during its Request for Comment period, a flat rate for ODFIs and their Originators can be paired with a tiered distribution rate for RDFIs. Such a model, while more complex than a straight pass-through, delivers benefits to RDFIs more quickly and will help them generate a return on their investment in Same-Day ACH processing faster than the 11.5 year payback originally projected by NACHA. Since the Interbank Fee for receiving a Same-Day ACH payment is the only financial benefit most RDFIs will get from Same-Day ACH, it is important that it be meaningful. The following numbers are hypothetical and for illustrative purposes only, but a tiered distribution model could certainly be developed. Using the original $.082/item interchange fee proposal, the model shown below puts a value of $.32 each on the first 1,000 items; $.12 on the next 9,000; $.06 on the next 40,000; and $.04 on anything above 50,000 items. At each stage, the calculation is either the planned per item amount or the undistributed revenue divided by the incremental number of items in that volume tranche. Banks A and B dominate the origination volume, much like top tier ODFIs do today. They also receive a little over half of the volume while Banks C, D, E and F represent typical financial institutions outside the Top 30. As it turns out, there was not enough revenue to pay all the tranches so the items in the 50K+ range were paid $.0352 each rather than $.04. Banks A and B see a reduction in their Interbank Fee income of 16% or less. Banks C and D are essentially unchanged. Banks E and F get a meaningful increase in their Interbank Fee income. This is a fairly simplistic model, but it shows that it is possible to distribute Interbank Fees in a way that will accelerate cost recovery for small FIs while not removing all the benefit from large ODFIs.

Flat vs. Tiered Distributions of Interbank Fees to RDFIs

	Bank A	Bank B	Bank C	Bank D	Bank E	Bank F	Total
Originated	100,000	80,000	11,000	5,000	0	0	196,000
Received	60,000	45,000	38,000	27,000	20,000	6,000	196,000
Orig Fee	$8,200	$6,560	$902	$410	$0	$0	$16,072
Rec'd Fee - Flat	$4,920	$3,690	$3,116	$2,214	$1,640	$492	$16,072
Rec'd Fee - Tiered							
0 - 1,000	$320	$320	$320	$320	$320	$320	$1,920
1,001 - 10,000	$1,080	$1,080	$1,080	$1,080	$1,080	$600	$6,000
10,001 - 50,000	$2,400	$2,100	$1,680	$1,020	$600	$0	$7,800
50,001 +	$352	$0	$0	$0	$0	$0	$352
Total	$4,152	$3,500	$3,080	$2,420	$2,000	$920	$16,072

Given that these calculations are more complex than the straight pass-through option, one alternative to consider would be a quarterly distribution of Interbank Fees rather than monthly. Given the projected benefits for most RDFIs, the monthly revenue isn't material so there's no financial harm in delaying the distribution. It should also be noted that NACHA's Same-Day ACH Rules do not specifically indicate the manner of Interbank Fee distribution. Instead, new Section 1.12 simply says "The National Association will arrange for a system for the collection and distribution of Same Day Entry fees." This would appear to leave open the possibility for alternatives to the flat-rate, monthly distribution originally contemplated without the need for a change in the Same-Day ACH Rules.

Other Considerations

Although not specifically requested by the Reserve Banks, there is a technical consideration that should be addressed. Section 6.1 of OC 4 states that a "Reserve Bank may reject, or may impose conditions to its processing of, any item for any reason." When considering the $25,000 maximum value for a Same-Day ACH item, how will the Federal Reserve, acting as ACH Operator, handle an item in excess of that amount? Traditionally, the ACH Operator would reject an item, batch or file that failed to comply with NACHA Operating Rules. The new definition of Settlement Date in Subpart 3.2.2 indicates that the ACH Operator will delay the settlement of the entire batch if it contains an item in excess of $25,000, so this appears to be a departure from prior FRB practices. While OC 4 does not address rules enforcement specifically and the current language in Section 6.1 of OC 4 gives Reserve Banks significant latitude to operate, it is important that decisions such as this be determined in advance of any acceptance of the Same-Day ACH changes to ensure that both NACHA and the Federal Reserve are aligned relative to the new Rules.

Thank you for this opportunity to comment.

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