TREASURY PRIME

ACH Guide: **Best Practices for Avoiding ACH Returns**

Why ACH returns occur, their impact on business, and how to prevent them.



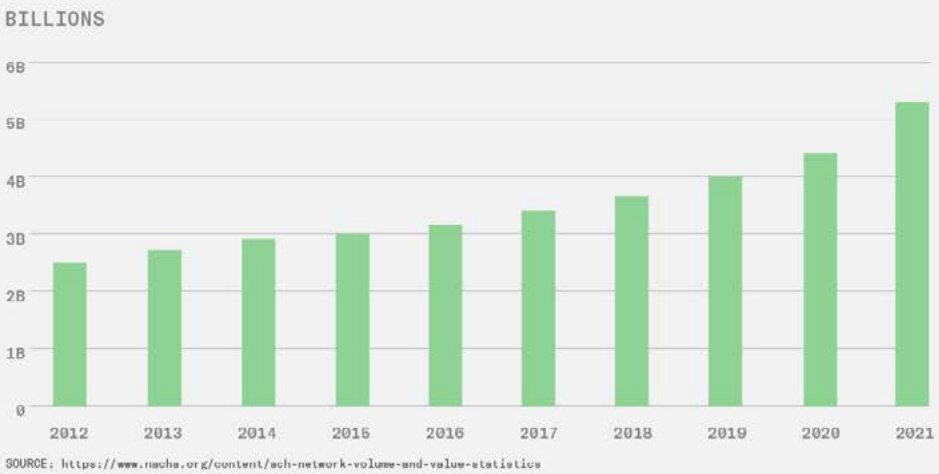
The ACH Network

Moving money through the ACH network is a foundational tool for businesses. ACH payments have progressed over the years to make transferring money safer, faster, and more convenient. And they're only getting more popular: in 2021, 29.1 billion transactions went through the ACH network, with a total value of $72.6 trillion. That's a nearly 9% jump in transaction volume and over 17% increase in value. What's more, businesses increasingly use ACH to make payments, with total dollars transferred at almost $50 trillion in 2021, according to Nacha, the organization which governs the ACH network.

However, like all payment rails, the ACH network is subject to risk. While more technologically advanced than checks and with some more flexibility than wires, ACH transactions are still subject to human error, nefarious behavior, and gaps in day-to-day business operations — all of which can contribute to ACH returns.

Businesses Increasingly Use ACH to Make Payments

B2B PAYMENTS BY VOLUME



SOURCE: https://www.nacha.org/content/ach-network-volume-and-value-statistics

2021 Key Metrics

YOY GROWTH:
PAYMENTS - 20.4%

TOTAL PAYMENTS:
5.32 BILLION

TOTAL DOLLARS TRANSFERRED:
$49.79 TRILLION

What Happens If an ACH Payment is Returned?

Literally speaking, an ACH return is a message typically from the receiving financial institution (RDFI) that informs the originating financial institution (ODFI) that it was not able to pull (collect) or push (deposit) funds into a receiver's account. Further discussion of the RDFI, ODFI, and other participants in the ACH network will be listed in greater detail below.

The outcome of an ACH return is that the transaction is rejected by the RDFI and the funds are reversed out of the intended destination and back to the starting point, which generally results in an ACH return fee similar to a return check fee. Costing anywhere from $2 to $5 to process, businesses offering ACH services to their commercial or consumer customers need to establish controls and adopt other risk management procedures to prevent regularly occurring ACH returns and the costs that come with them.

In addition to the financial downsides presented by ACH returns, there are regulatory risks that are associated with ACH returns. Specifically, a high rate of ACH returns can be an indicator to your bank or financial institution that you're a risky client to have and can jeopardize your relationship in the long term. This is especially the case because financial institutions are required to keep ACH return rates below certain thresholds under Nacha Operating Rules.

See Nacha Rule on Unauthorized Returns.

ACH Returns?

ACH returns can have lasting impacts on your business, but there are best practices you can consider to decrease or prevent them. Next, we'll cover some basics around what the ACH is, what ACH returns are, how they work, and some tips on how your business can decrease or avoid ACH returns and save your money.

(Note: While we are providing some best practices below, this is not a comprehensive guide and should not be taken or considered as legal advice and protocol for guaranteed prevention of ACH returns. This is general advice and should be taken as informative and educational.)

What is ACH?

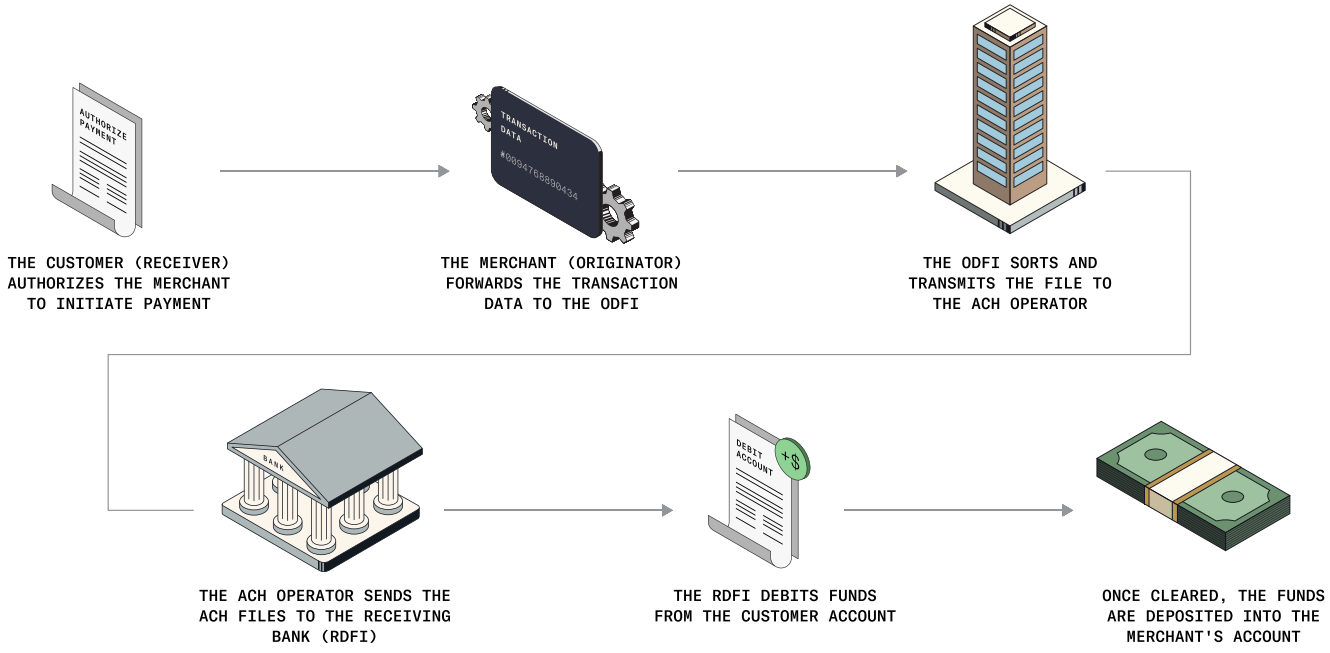
The ACH, otherwise known as the Automated Clearing House, is something many Americans leverage in their day-to-day lives through transactions including receiving a direct deposit paycheck from an employer or paying a utility bill directly from your checking account.

Essentially, the ACH is an electronic fund-transfer system that powers the movement of trillions of dollars in the U.S. annually. Having been established in the 1970s, the ACH network is operated by Nacha. Nacha — formerly known as NACHA, the National Automated Clearing House Association — oversees the ACH network and its operators and ensures that member banks are compliant and interprets policy and legislation into actionable rules and procedures. We'll talk more about Nacha further below.

How Does ACH Work?

As mentioned above, the ACH network allows for two methods of money movement: A direct transfer or a direct payment. Specifically, in the ACH vernacular, the payment types are generally classified as an ACH debit or an ACH credit.

The ACH network is an electronic payment rail that enables the electronic transfer of money from one bank to another without reliance on paper checks, wires, or the card network. For example, when it's payday and you've



opted for direct deposit, your employer would initiate an ACH credit, instructing the ACH network to send funds from its bank account to yours. Similarly, if you are making a regular contribution to a retirement fund, your fund may initiate an ACH debit and instruct the ACH network to take money from your account. Every ACH transaction or entry goes through these two different financial institutions that are authorized by Nacha.

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The originator of an ACH can be an individual, an organization, or a governmental organization. The originator's bank is known as the originating depository financial institution (ODFI) while the receiver's bank is the receiving depository financial institution (RDFI).

ODFI: The Originating Depository Financial Institution. The ODFI acts as the layer between the party that initiates an ACH transaction (the "originator") and the ACH network. Generally, an originator is a business, individual, or governmental body.

RDFI: The Receiving Depository Financial Institution is the financial institution that receives the funds of the ACH transaction, validates and processes the transaction, and posts funds to an end-user's account. The RDFI is typically a bank or credit union and would also be responsible for letting the originator know if any information for the ACH entry is incorrect.

An ACH operator receives the batch of ACH transactions from the ODFI in a specific format known as a Nacha

file. The ACH operator sorts the batch and makes transactions available to the bank of the intended recipient, or the RDFI. The batch scheduling means ACH transfers settle and are thereby completed in one to three days.

An example of how the ODFI and RDFI work together can be seen in how we use our money in our day-to-day lives. To harken back to our example of being paid by an employer, your employer would be an originator that initiates an ACH credit to its ODFI (a bank for instance) requesting that funds be sent to your bank account. Your bank or credit union would be the RDFI and process the ACH entry from your employer and post the funds to your account in a timely manner.

Not every financial institution will be an ODFI or RDFI. Some financial institutions may choose to be or only be certified as one or the other or both.

Let's dive a little deeper in the next section.

ACH Pulls vs Push Payments

ACH payments can generally be broken into two categories: Push payments, and pull payments. The main differentiator between these two payment types is the originator of the request.

Push payments can be considered credit transactions, in which a payer (the originator) instructs their bank to send money out of their account to another account.

On the other hand, pull payments can be considered debit transactions. The intended recipient's bank will request a transfer and pull money from a payer's account.

For example, if you're looking to pay a recurring utility bill with your checking account, you could set it up so that a withdrawal is regularly initiated to take — or push — funds from your account and send payment to the utility company. Or, you could also provide the utility company with your bank account and routing numbers so that it can initiate an ACH debit — or pull — money from your account.

An easy way to think about this is that in a push payment, the account holder

or the originator sends the money, while in a pull payment the originator is taking money.

Different rules also apply for push and pull payments. For instance, if a push payment is initiated with insufficient funds, your financial institution or bank may penalize you with fees. However, if a supplier or company tries to pull money from an insufficiently funded bank account, the supplier simply won't get paid (though it may incur its own fees on your outstanding balance).

ACH Payments: common questions and rules

ACH transfers are an increasingly popular mode of money distribution because they're secure, convenient, economical, and relatively fast. There's no longer the need to write a check and in most cases, money can be sent and received in just one to three business days.

An ACH transfer costs a nominal fee and is one of the most widely accepted forms of payment. Same-day ACH exists but costs more than standard ACH which takes up to three days.

The low cost of ACH provides options for fintechs and embedded banking apps to earn revenue. It's not very expensive to offer ACH transfers for free as a perk, which fintechs often leverage to encourage users to utilize their other features. But fintechs can also charge for ACH transfers, and at competitive rates, to earn revenue from ACH directly. Users are especially willing to pay a seemingly nominal fee for an ACH transaction where other features and tools enhance and complement the ACH rail, creating a positive user experience.

And when compared to checks, it's obvious why ACH transfers are preferred. Accepting checks can be 16 times more expensive than ACH transfers. Of course, ACH transfers aren't perfect and have their drawbacks.

First, despite ACH transfers being purely electronic transactions, there is still processing time needed, which is why a transfer isn't necessarily instant. Once an ACH transfer is made, the ACH network still needs to process the transfers and the banks on both ends of the transfer need to either debit or credit an account. Nacha currently

mandates that debits to an account are settled in a business day while credits are given up to two business days after the transfer is initiated.

On the topic of timing, ACH transfers also have limits depending on when a transfer is started. Banks have different cut-off times for when they'll send a transfer, meaning that if you miss the cut-off window, your payment may be delayed — a possibly significant inconvenience if you're trying to pay a bill on time.

Because Treasury Prime integrates directly with banks' core technology, instead of doing end-of-day batching for ACH entries like other BaaS providers, Treasury Prime can facilitate real-time payments for its customers — just another safeguard against ACH returns. Talk to our team to learn more about what our API can do.

Additional drawbacks to ACH can be bank-imposed limitations. Some banks may set a limit on how large an ACH transfer can be or set a limit on how much money can be transferred out of your account on a daily basis. Other banks may also incur a penalty if too much money is being transferred out of your account over a certain period of time. Further, some banks may not allow you to make an ACH transfer to a bank outside of the country.

So how can you be sure that you're transferring money to the right person or what if you made a mistake? Thankfully, ACH transfers can generally be reversed or disputed and every bank will have a different method of doing that. We'll cover this next.

Nacha Compliance

Only Nacha-certified banking institutions can be a part of the ACH network. Nacha has a 700-page operating guide for financial institutions to abide by and Nacha also allows financial institutions to submit reports of guideline violations. In the BaaS paradigm, the bank is the financial institution responsible for adhering to Nacha rules. However, by extension, fintechs and enterprises might be subject to certain rules by their bank partner.

Nacha continues to oversee, refine, and

enforce its guidelines across the ACH network (including The Federal Reserve and Clearing House) to ensure that businesses and individuals can safely move and receive money.

What is ACH vs wire transfer?

Many have also likely heard of the term "wire transfer" as well.

Wire transfers are electronic transfers of money facilitated by an international network of banks and transfer agencies. It allows large, same-day transactions to safely move between two parties across different locations or countries without exchanging physical money. Wire transfers are also not run through the ACH network or the same clearing houses, but rather through the Fed's FedWire settlement system (or the Society for World Interbank Transactions for international wire transfers).

Wire transfers share some similarities to ACH transfers. Wire transfers, like ACH transfers, require processing time to settle. Wire transfers, which occur between two financial institutions typically settle within a single business day and generally don't take more than a few business days.

In exchange for speed, wire transfers are less forgiving. Once a wire transfer is initiated and completed, it's essentially permanent. Unlike in an ACH transfer, once someone initiates a wire transfer, the recipient will get the funds even if the initiator empties their account. Because banks take on this risk, wire transfers can be just about as expensive as check processing, with $10 to $20 per transfer.

With this, It's especially important for the originator of the wire transfer (wire transfers only go one way, from the person initiating the transfer) to be sure of whom they're sending their funds to as wire transfers are typically much larger than ACH transfers, usually in the thousands to millions. Generally, wire transfers are used for more significant transactions like a down payment on a house.

What are ACH Returns? How are they different from an ACH Reversal?

ACH Returns:

An ACH return occurs when a transfer simply doesn't go through. There are several reasons (we'll get to this soon) this might happen, including:

- Insufficient funds
- Incorrect information provided such as the wrong legal name of an account holder
- Wrong account number given

When any of the above occurs, the RFDI will need to notify the ODFI of the return so that the ODFI can process it. Depending on the reason for the return, the processing time can be as little as two business days.

ACH Reversals

Similar to an ACH return, reversals occur when the originator requests to have the entry returned or reversed. While ACH transactions have made sending and receiving funds easy, there is still a manual element that can be hampered by human error.

ACH returns and reversals serve a similar purpose in that they're both ways to find a solution to an ACH transaction not reaching its intended destination. However, both do have key differences in how they're processed and the rules that they must abide by.

Because ACH entries don't typically occur in real time (unlike wire transfers), it's still possible to try and rectify any issues using ACH returns or reversals. An originator of the ACH entry may list the wrong name, incorrectly list an account number, request an erroneous payment or withdrawal, or initiate the credit or debit on the wrong date.

ACH Return Codes

ACH codes are used to easily identify why an ACH payment was returned or reversed. At the time of writing, there are currently over 80 ACH return codes, though the list (and the rules that govern each return code) is subject to change as Nacha continually maintains the list *(see chart on page 14)*.

Each return code begins with an R followed by a two-digit number and denotes specific reasons an ACH payment didn't properly reach its destination. Some common ACH return

codes are R01 (insufficient funds) and R02 (account closed), while less commonly used return codes include R13 (invalid ACH routing number) and R83 (foreign RDFI unable to settle). Each ACH return code will have different processing parameters set by Nacha, like how quickly a return must be settled and what role the OFDI and RFDI play in the processing.

ACH returns: common mistakes and remedies

As we've covered, ACH returns can often occur because of human error, but there are common operational reasons as well including:

1. Lack of customer risk profile: Some customers are simply dangerous to have. If you're not monitoring customer risk profiles via transaction monitoring or — even better — preventing dangerous customers from joining your platform during the account opening KYC process, ill-intentioned users could slip through the cracks

2. No recurring payment system: Not only is having an inconsistent payment schedule with your end-users cumbersome, it can expose your business to needless ACH returns. By having recurring payments, you ensure that your ACH entries are always linked to the right accounts with the right information.

3. Recurring payments can also be a sign of a trustworthy customer, meaning you can build better rapport with these customers and provide custom solutions for them like a shorter ACH settlement period. Treasury Prime allows their customers to set these custom settlement parameters for their own end users for this exact reason.
4. Inadequate transaction logs: It's important to keep an ongoing record of your ACH transactions. In the case of an ACH return, reversal, or any other possible mishap, having these transactions easily available can be the key to finding a quick solution.

5. No customer documentation: Whether your business deals with other businesses or with individual customers, many of them will change things about themselves: Names,

addresses, financial institutions, etc. Not having a system in place to track or request information on those changes can cause ACH return headaches.

6. Uninformed customer base: ACH returns are not only annoying for businesses but also for customers who want to send or receive their money. Customers may not be aware that they could be contributing to a higher rate of ACH returns and just need some guidance. Investing in customer education can be a worthwhile proactive preventative measure.

The above isn't an exhaustive list, so it's understandable how daunting it can feel, especially if you're a smaller business with limited resources.

The negative impacts of ACH returns

There's one glaring reason to avoid ACH returns: *They cost money.*

While ACH return fees charged by banks and other financial institutions can seem nominal, they can stack up. If your business is consistently seeing ACH returns — even if just for a small portion of your customers — it will undoubtedly hurt your bottom line.

The cost of ACH return fees will depend on the business, but with the cost of initiating and receiving an ACH payment at 26 to 50 cents, any unnecessary cost can be dangerous, particularly for smaller businesses.

And as the adage goes, "time is money." Processing ACH returns requires manpower, time, and energy that could be going toward more pressing business needs.

And finally, there is the issue of regulatory and reputational damage. A high number of ACH returns can give banks and other financial institutions the impression that you may be onboarding customers or interacting with companies that may have questionable transaction history. Similarly, customers who experience ACH returns and reversals may also lose trust in your business as well.

Aforementioned, Nacha itself also imposes limits on ACH returns based on the percentage of ACH debit returns

for the previous 60 days. However, most banks and financial institutions track returns on a rolling 30 and 60-day basis:

- **Administrative Returns:** (Return reason codes: R02, R03, and R04) Are required to stay below 3% of your ACH entries.

- **Unauthorized Returns:** (Return reason codes: R05, R07, R10, R29 and R51) Must stay below 0.5%.

- **Overall Returns:** (All return reason codes) must stay below 15%. This percentage is calculated based on ACH debit returns for the preceding 60 days and includes all return reason codes. This includes NSF (non-sufficient funds) returns

In short, ACH returns cost money and time, and rising ACH rates are a leading indicator of risk to financial institutions — a major red flag for fintechs and enterprises looking to innovate with bank partners.

Mitigating ACH Returns

While there is no way to eliminate risk completely from the payment rail, many institutions have controls to mitigate ACH Returns. One example is leveraging a micro-entry, which is a small dollar ACH transaction used to validate a sender or receiver's access to the account.

There are also third-party account validation tools that validate identity like Plaid's identity verification which uses bank data to verify a user's identity. The most foundational way to avoid fraud is to ensure you have appropriate KYC and onboarding controls in place on your platform. It is also important to have the ability to monitor and prevent nefarious activity from occurring through your application. Your bank partner should be a trusted partner and collaborate with you to ensure robust compliance and risk management practices.

Treasury Prime is an embedded banking software platform that has the technical tools and resources to help your business put preventative measures in place to best avoid ACH returns — among other common mistakes — and a team that can help you navigate what happens if an ACH return does occur.

RETURN CODE	ACH RETURN	DESCRIPTION	ACCOUNT TYPE	TIME FRAME
R01	Insufficient Funds	The customer does not have sufficient balance to cover the ACH transaction.	ALL	2 Banking Days
R02	Account Closed	An account that used to be active is now closed.	ALL	2 Banking Days
R03	No Account / Unable to Locate Account	Account number or routing number does not match the customer name. Often the result of a typo.	ALL	2 Banking Days
R04	Invalid Account Number	Invalid account number structure	ALL	2 Banking Days
R05	Unauthorized Debit to Consumer Account Using Corporate SEC Code	Invalid account number structure	CCD, CTX (consumer only)	60 Calendar Days
R07	Authorization Revoked by Customer	Consumer who previously authorized ACH payment has revoked authorization from the Originator.	PPD, TEL and WEB	60 Calendar Days
R08	Payment Stopped	The account owner has placed a stop payment	ALL	2 Banking Days
R09	Uncollected Funds	While there's sufficient balance, transactions being collected bring the balance below the debit value.	ALL	2 Banking Days
R10	Originator not known and/or not authorized to Debit Receiver's Account	The Receiver has notified the RDFI that the Originator has not been authorized to debit this account.	ALL DEBIT ENTRIES (except CCD, CTX and RCK)	60 Calendar Days
R11	Customer Advises Entry not within Authorization terms	The entry was inaccurate or does not conform to the terms of the authorization	ALL DEBIT ENTRIES (except CCD, CTX and RCK)	60 Calendar Days
R16	Account Frozen	The funds in the account are unavailable due to action by legal action or the RDFI	ALL	2 Banking Days

Want to simulate an ACH transfer and payment rails without having to open bank accounts?

Play around with our Developer Sandbox and view our API reference. Wondering how embedded banking could help your business? Contact Treasury Prime — we have a true multi-bank network, the deepest bank core integrations, and extensive compliance experience. Tearsheet named us the Best Banking as a Service company for the second year in a row.

Talk to the best embedded finance team in the industry.

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ABOUT TREASURY PRIME

Treasury Prime is the leading Banking as a Service (BaaS) company that connects enterprise companies to banks so that they can embed a full range of banking services to increase revenue streams, bolster customer loyalty, and offer rewards. From opening accounts to making payments to issuing cards, Treasury Prime's APIs allow companies to plug into the widest bank network in the industry to create innovative new products of the future, fast.

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