Building The Better Bank

Third-Party Senders – Risks and Best Practices
• Please turn off all cell phones or mobile devices.
• Thank you to today’s sponsors!
  – This morning’s refreshment break sponsored by The Royal Bank of Scotland
  – EventMobile sponsored by S1
  – Wireless Internet sponsored by Western Union
• All conference attendees will have free access to PAYMENTS 2010 conference session recordings. Attendees that registered onsite will receive details to access the session recordings within 10 days.
• Should you wish to purchase a CD-ROM, a special conference rate is offered to all conference attendees.
• Most of the education sessions at the conference can be counted towards your continuing AAP accreditation. If you are interested in becoming an Accredited ACH Professional (AAP), please stop by the NACHA & RPA booth.
• Please take a moment to complete session evaluations! Each evening attendees will receive an email link to access session evaluations that are offered each day. Attendees are automatically entered into a daily drawing for a chance to win a $50 gift card.
Speaker Info

**Sara Pinkus, AAP, CAMS, CISA**

VP/Cash Management Risk & Compliance

TD Bank, America's Most Convenient Bank

6000 Atrium Way
Mt. Laurel, NJ 08054
Phone: 856-533-2923
spinkus@yesbank.com

Current member of the NACHA Risk Management Advisory Group

**John Wagner, NBE, CAMS**

Director, BSA/AML Compliance

U.S. Department of the Treasury, Office of the Comptroller of the Currency

250 E. Street, S.W.
Washington, D.C. 20219
Phone: 202-874-6073
john.wagner@occ.treas.gov
Session Agenda

- What are Third-Party Service Providers (TPSP)/Senders (TPS)?

- What is the Regulatory Guidance?

- What are the Consequences of Non-Compliance?
  - Penalties, Enforcement Actions, and Reputation
  - Common Themes – Examination Issues & Root Causes

- What are the Best Practices?
Performs a function of ACH Processing on behalf an ACH participant (Originator, RDFI or ODFI)
# ACH Third-Party Service Providers

<table>
<thead>
<tr>
<th>ACH Third-Party Service Providers (TPSP)</th>
<th>ACH Third-Party Senders (TPS)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Originates ACH on behalf of an <strong>FI’s</strong> customer</td>
<td>Originates ACH on behalf of their customers</td>
</tr>
<tr>
<td>ACH Origination agreement is with the <strong>FI</strong> customer</td>
<td>ACH agreement <strong>with TPS, not</strong> their customer</td>
</tr>
<tr>
<td>ACH settlement account: the <strong>FI customer’s account</strong></td>
<td>ACH settlement account: <strong>TPS’ account</strong></td>
</tr>
<tr>
<td>Separate stand-alone agreement between FI and the (TPSP) recommended</td>
<td></td>
</tr>
</tbody>
</table>
Payment Processor

- Uses its bank relationship to process payments for merchant clients
- Could be depositing Remotely Created Checks (RCCs) on behalf of its merchant clients
- Could be acting as an ACH Third-Party Sender (TPS)
Regulatory Guidance

- OCC
- FFIEC
- NACHA

All identify potential risks and provide best practice guidance and in the case of NACHA even specific rules.
Adds complexity

Increased exposure to compliance, credit, transaction, and reputation risks

Bank remains legally responsible, but does not have direct control

Risks even higher when third party is permitted direct access to ACH Operator

Bank has no direct customer or contractual relationship with the originator (in case of Third-Party Sender (TPS))
References OCC Bulletin 2006-39 ACH Activities Risk Management Guidance

ACH transactions originated through a TPS (where Originator is not direct customer of the ODFI) makes it difficult for an ODFI to underwrite and review Originator transactions for compliance with BSA/AML rules

Neither the TPS nor the ODFI performs may be performing due diligence on the companies for whom they are originating payments

Because ACH processing is highly efficient and more automated than individual funds transfers, there are fewer opportunities for human review of individual transactions
OCC 2008-12 Payment Processors: Risk Management Guidance

- Guidance for due diligence, underwriting, and monitoring payment processors
- Supplements ACH risk management and Remotely Created Check (RCC) guidance
- Risks are heightened when neither the processor nor the bank performs adequate due diligence on the merchants for which they are originating payments
- Proper initial due diligence, effective underwriting, and ongoing monitoring are critical control mechanisms
Article 5 – Obligations of Third-Party Senders (TPS)

- Identification of Originators
- Warrants that Originator assumes responsibilities of Originator
- ODFI liable for performance of TPS; binds TPS to the Rules
- ODFI’s right to terminate agreement for breach of rules, right to audit (effective June 18, 2010)
- Additional rules are under consideration
Section II, Chapter II (ODFIs), subsection B-3 (Agreements/Relationship with Originator)

3. AGREEMENTS/RELATIONSHIP WITH ORIGINATOR

In an environment where an increasing number of unauthorized transactions or transactions arising from deceptive business practices are being made over the ACH Network, it is becoming more and more critical that financial institutions take proactive steps to safeguard their financial assets as well as their reputations. **One fundamental step toward this goal is to ensure that ODFIs know their customers.** To protect themselves against financial loss, ODFIs must ensure that their Originators are credit-worthy. ODFIs should also strive to ensure that such Originators are engaged in reputable business practices.
What are the Consequences of Non-Compliance?

- **Increased Costs ($$$)**
  - Penalties
  - Enforcement Actions
  - Violations of Law

- **National Bank (Temporary & Permanent C&D)**
  - New Customer (ACH Third-Party Sender (TPS)).
  - No risk assessment performed.
  - Risk managers **not** included in vetting of new relationship.
  - Insufficient Due Diligence on ACH Originators and Customer
  - Merchants were involved in online gambling, online payday lending, online pharmacies, and online cigarette outlets
  - Monitoring/Red Flags: Unauthorized ACH transaction increased tremendously
  - Red Flags: OFAC hits increase tremendously
What are the Consequences of Non-Compliance?

**National Bank** (CMP, Restitution, Education Fund)
- $10 Million Penalty, $150 Million Restitution, $8.9 million Education Fund
- Litigation expense, investigative / research expense, time and resources
- Customer: Third Party Processor (Remotely Created Checks)
- Finding of an Unsafe and Unsound practice
- Failure to conduct suitable Due Diligence (high risk customers)
- Owner of Company named in public FTC actions
- Poor risk recognition and response
- Insufficient Policies and Procedures to manage risk
- Failure to monitor return rates and investigate allegations of consumer fraud
- Red Flags: Internal warnings, law enforcement inquiries, complaints from other FIs
- Red Flags: Huge volumes of unauthorized transactions (> 50% return rate)
Common Themes - Examination Issues & Root Causes

- Poor / Insufficient Due Diligence
- Incomplete Risk Assessments
- Policy and Program Weaknesses relative to Guidance
- Plentiful Red Flags
- Focus on Revenue / Income vs. Risk Management
Board approved policy

- Direct Access to ACH Operator – is it allowed or not allowed. If so, under what circumstances, who approves, etc.

- Third-Party Service Providers (TPSP) – if on behalf of the FI should follow normal vendor/supplier policies

- Third-Party Service Providers (TPSP) on Behalf of Originators - what agreements are required between Bank and TPSP

- Third-Party Sender (TPS) – tolerance for risk, approval requirements, client types not permitted, permitted SECs
Understand the Business

- What types of businesses are their clients engaged in?

- What due diligence do they perform on their clients?

- How many clients do they process for? What is expected growth rate?

- How is the risk of clients not having sufficient funds handled?
Best Practices – Due Diligence Documentation

- Background checks on the business and its principals
- Financial statements
- SAS70 or independent audit report (provide annually)
- TPS’ client agreement binding its client to NACHA rules
- TPS client listing
- Website Review/Internet Search
Best Practices – On Boarding

- Background checks on the business and principals (using public database such as Lexis Nexis, RDC)
- Effective Underwriting; consider prefund
- Third-Party Sender (TPS) consider requiring that it be an established business (i.e. business for at least 5 years)
- Consider requiring that the TPS use other banking services of the organization (i.e. must have a full banking relationship or require they be a borrowing customer and/or maintain certain balances)
- TPS must not process for clients engaged in specified high risk businesses (such as telemarketing, gambling, payday lending, adult entertainment)
In addition to all language applying to a normal originator, agreement between ODFI and Third-Party Sender (TPS) should provide that:

- TPS client assumes responsibilities of Originator
- ODFI has right to terminate/suspend the TPS/Originator of TPS for breach of Rules
- ODFI has right to audit the TPS and its Originators for compliance with Rules
- Acknowledgement that TPS has access to the NACHA rules
Best Practices – Operating Criteria

- Third-Party Sender (TPS) will not process for additional originators without first notifying the Bank and obtaining Bank’s approval.

- TPS will only submit Prearranged Payment & Deposit (PPD), Corporate Credit/Debit (CCD) or Corporate Trade Exchange (CTX) entries. Any other Standard Entry Codes must be pre-approved.

- The Bank should regularly monitor the accounts of the TPS (return rates, exposure limits, change in risk profile, continued creditworthiness).

- Consider conducting audits of TPS.
References


- NACHA Operating Rules and Guidelines www.nacha.org