



***Private-Sector Operating Rules:
A Payments Network Perspective***

***Administrative Simplification Under the
Patient Protection and Affordable Care Act:
Operating Rules for Eligibility and Claims Status***

JULY 20, 2010

U.S. Department of Health & Human Services
National Committee on Vital and Health Statistics (NCVHS)
Subcommittee on Standards

**Janet O. Estep
President and Chief Executive Officer**

PRIVATE-SECTOR OPERATING RULES

A Payments Network Perspective

Summary

NACHA – The Electronic Payments Association is pleased to submit this written testimony to the National Committee on Vital and Health Statistics (NCVHS) as it reviews the administrative simplification provisions (Section 1104) of the new *Patient Protection and Affordable Care Act*. As requested, NACHA is providing information on how private-sector operating rules have been developed to manage the ACH Network (the Network), the lessons learned over time, and suggestions on where there may be parallels between operating rules use in the financial industry and operating rules use in healthcare administration.

Today, the ACH Network is a widely used, trusted, and efficient network for the direct, electronic movement of money and information between bank accounts, including Direct Deposit of payroll, government payments, and corporate trade payments. It carries more than \$30 trillion each year to and from the financial accounts of consumers, small businesses, corporations, and government. Because electronic payments need to be accessible to all consumers, all businesses, all financial institutions, and all government entities, it is critical that both payments and related information are formatted and sent in a common manner. This is all enabled by adaptive operating rules that have incorporated various types of standards and regulations over time.

As an organization and a payment network that collectively has been developed and utilized for over 35 years, NACHA has fine-tuned its rulemaking and voting processes which are inclusive, transparent, and flexible. Processes have been developed to engage thousands of entities in voting on rules, as well as in dialogue and education. As a result, the ACH Network is known for being fair and equitable to all participants, and at the same time, has been adaptive in regards to technology and innovation.

As healthcare faces an opportunity to achieve greater efficiency, it is essential to focus on operating rules that call out not only prescriptive standards, but also the roles, rights, and responsibilities of

the involved parties so that there is clarity and certainty of outcomes. In this testimony, I will describe the benefit of private-sector rulemaking, the rulemaking processes, and offer a perspective on the definition of “operating rules” vs. “standards,” providing insights at this critical time as we approach the development of healthcare operating rules.

Introduction – NACHA and the ACH Network

The ACH Network, in both its logical and physical construct, represents an ideal model to consider as the Department of Health & Human Services implements administrative simplification, and as this Subcommittee seeks to understand the nexus between “operating rules” and “standards” in the context of healthcare transactions.

The ACH Network is an all-electronic funds transfer payments system used by more than 14,000 financial institutions, more than 3.5 million businesses, and at least 160 million consumers to make and receive electronic funds transfers or EFTs. In 2009, there were almost 19 billion Network payments made worth over \$30 trillion dollars. The size and scope of the Network necessitates that it functions as a safe and secure means of transmitting funds and related information.

The ACH Network is most easily recognized by its Direct Deposit application – the ability for employees all across the United States to electronically receive their payroll deposit from employers of all sizes. The Network also supports Direct Payment of consumer bills, business-to-business payments, echeck, and ecommerce payments. The largest user of the Network, the Federal government, sends payments such as Social Security benefits, payroll and tax refunds, and has the ability to receive tax payments electronically via the efficient ACH Network.

NACHA is the not-for-profit association responsible for the administration and enforcement of the operating rules for the ACH Network – the *NACHA Operating Rules*. These *Rules* support payment products and business practice standards in the areas of electronic bill payment, ecommerce, echecks, electronic data exchange, and international payments. We represent and bring together over 10,700 member financial institutions of all sizes and types throughout the United States, both

directly and through our 18 Regional Payments Associations, and more than 450 other companies and organizations through our industry councils and Affiliate Membership program. Our structure allows us to be inclusive of many different types of organizations, and our processes create venues for their ideas and opinions to be heard. Venues include those to suggest new *Rules* ideas, to educate the broad industry in a variety of ways, and for industry dialogue and collaboration. Additionally, NACHA's core competency in creating operating rules has been leveraged by other organizations when faced with the goal of bringing diverse parties together. NACHA wrote and administers the *QUEST*[®] *Operating Rules* for electronic benefits, supporting collaboration between government and industry. NACHA also served to offer support to CAQH during its initial development phase of the CORE operating rules.

A history of the ACH Network, NACHA, its education and training services is attached to this testimony as Appendix 1.

Operating Rules Incorporate Standards

Although some may refer to “operating rules” interchangeably with “standards,” there is a significant difference that manifests itself upon implementation and in the resulting benefits to the participating entities. Specifically, most often, rules define the rights, obligations and warranties of parties involved, while standards establish technical requirements.

Operating rules establish the roles, rights and responsibilities of the parties exchanging data and/or value (and often prescribe formats for the process) to enable transaction initiation, processing and completion, error resolution, and liability apportionment. The *NACHA Operating Rules* also define data formats when specific, consistent data is required from all Network participants. By specifying the required data formats in the *Rules*, the *Rules* enforcement mechanisms can also be applied to ensure all follow the formats.

The primary purpose of standards is to establish technical requirements on the basis of a level playing field, thereby encouraging broad applicability and low barriers to entry by establishing

certainty around the necessary requirements among parties to a transaction. For electronic payments, standards in combination with operating rules define data formatting and transmission requirements, so that the data is interoperable among all parties to a transaction and any technology and service providers.

There is a hierarchy and inter-relationship between operating rules and standards, with standards (and potentially multiple standards) as a sub-component of operating rules. For example, standards by themselves would not be sufficient to direct all participants in the Network, but they are an essential part of how ACH payment transactions are supported. Often operating rules will directly embrace or impose a standard (or indirectly benefit from the existence of a standard); but operating rules themselves are generally agnostic to the version of a standard.

The *NACHA Operating Rules* provide the framework for all ACH Network transactions. All participants in the Network are required to follow the *NACHA Operating Rules*. Financial institutions enter into contractual agreements with the Network Operators, and companies enter into contractual agreements with their financial institutions, obligating their adherence to the *Rules*. These contractual agreements allow the *NACHA Operating Rules* to be enforced through the legal system. By entering into an agreement to comply with the *NACHA Operating Rules*, Network participants also become subject to Network rule enforcement mechanisms.

There are some specific examples of standards and operating rules that are complementary in the payments area that may be used to help explain this hierarchy. For example, the *NACHA Operating Rules* incorporate the data formatting standards for all ACH transactions. This interweaving of *Rules* and standards ensures that any ACH transaction, regardless of who initiates it, can be processed in an identical manner by any other Network participant. Through the *NACHA Operating Rules*, these data formats can be altered or new ones created, to meet the needs of ACH Network users as needs change over time. Currently ASC X9 and X12, UN/EDIFACT and XML¹ messages or data segments are carried through the ACH Network. Changes to any of these standards do not

require that the *NACHA Operating Rules* or ACH formats have to change. Conversely, changes to the *Rules* or formats can be made without requiring a change to relevant standards.

In addition to the data format standards for all ACH transactions, the *NACHA Operating Rules* also incorporate standards for the formatting of payment-related information that is often carried with a transaction. For example, with respect to business-to-business payments, the NACHA payment format can accommodate remittance information in any version of the standard EDI formats. This ensures that business trading partners can exchange remittance information with each other across the ACH Network. The Federal government is a significant user of this capability of the Network.

The *NACHA Operating Rules* also accommodate a number of other “banking conventions” for formatting data using valid EDI data format standards for specific objectives. Case in point, the *NACHA Operating Rules* currently support healthcare-related payments and information, and utilizing the ANSI ASC X12 835 and 820 transaction sets allows the payment and related information to flow through the Network. (See Appendix 2 for more information on how the Network can support healthcare payments.) Several other uses support government-related purposes or mandates, such as remittance information that accompanies tax withholdings and child support payments.

Additionally, the interweaving of operating rules and standards are evident in international venues. In Europe, the Single Euro Payments Area (SEPA) initiative has a goal of enabling seamless non-urgent electronic payments across European countries. This initiative aims to improve the efficiency of cross border payments and turn fragmented national markets for euro payments into a single domestic one through the development of operating rules and payment orders developed using the ISO 20022² standard. A similar approach was taken with the International Payments Framework (IPF), which is a financial services industry initiative to develop operating rules and standards to efficiently pass non-urgent electronic payments between IPF members around the globe. The IPF has also used ISO 20022 to facilitate the passing of transactions, and has developed its version/use case of the ISO 20022 along with operating rules for implementation.

In all of these examples, there are “rules” that govern the party who may initiate the payment and the responsibilities of each of the parties to the payment, and there are data formatting requirements and “standards” that enable the transactions to be processed efficiently by all parties. In order to deliver healthcare administrative simplification, not only standards, but also operating rules which build upon those standards, are vital to an effective nationwide program and its sustainability.

The Benefits of Private-Sector Rulemaking

Through the *NACHA Operating Rules*, the Network establishes a legal framework that ensures consistency and certainty for all participants, and facilitates commerce, electronically, by serving as an efficient, secure, reliable, interoperable, and green payments system that benefits financial institutions and their customers, as well as government entities of all types.

Private-sector rulemaking provides the flexibility to promptly identify and respond to participant requirements and new technologies, and to define in sufficient detail the roles and responsibilities of participants in the ACH Network. From this foundation, the *NACHA Operating Rules* promote innovation and efficiency, interoperability, and provide security and certainty regarding these payments.

Innovation. Private-sector rulemaking with broad stakeholder involvement, like that in place for the Network, provides opportunities to implement technological and business process advancements in a prompt but controlled manner. Over the past nine years, the number of consumer ACH payments initiated via the Internet has gone from virtually zero to more than 2.2 billion annually, moving almost \$1 trillion.

Efficiency. Driven in large part by the common set of rules that govern it, the ACH Network connects virtually all financial institutions in the U.S. This universality makes it possible for consumers to receive wages or benefits by Direct Deposit at the financial institutions of their

choosing, and for businesses to be able to accept payments drawn at accounts at any financial institution.

Interoperability. The Network, in combination with the Rules, provides for the uniform movement of data from one system to another in such a way that the operational purpose and meaning of the data is preserved and unaltered regardless of the technology used. This drives efficiencies for all utilizing the Network.

Security. The ability to readily amend the *NACHA Operating Rules* protects all Network participants. Over the past seven years, the *NACHA Operating Rules* have been amended to improve risk management, reduce the incidence of unauthorized transactions – one indicator of quality and security on the Network – and increase enforcement of the *Rules*. In 2009, the rate of unauthorized transactions to consumer accounts was at an all-time low; and the incidence continues to drop, with a 16% decline in the 1Q of 2010 versus the same time period in 2009.

Certainty. The *NACHA Operating Rules* address the unique characteristics of the ACH Network. This provides all Network participants and their customers with the knowledge and certainty of the manner in which the electronic payments are processed, when they will be received and their specific rights and responsibilities. This also creates certainty of outcomes in the event of an error or a disputed transaction.

Private-Sector Rules Development and Voting

Critical to the success of the *NACHA Operating Rules* is that they are amended through a deliberative and inclusive process similar to that used by Federal agencies under the *Administrative Procedures Act*. The process is inclusive, transparent, and adaptive to the needs of the electronic payment marketplace. All participants in the Network – commercial banks, community banks, credit unions, large corporations, small businesses, consumer advocates, and industry vendors – have the opportunity to comment on proposed rule changes. When needed changes are required for

the benefit of the Network, there is a methodical, prescribed manner by which options are considered, impact is assessed, and voices of all participants are heard.

The rulemaking process is not brief, but it is flexible in terms of adapting to changes in the landscape, technology, and risk. Proposals for new rules may come from one of several industry Councils of NACHA, or from individual organizations, and they are raised up via a structured evaluation process. The Councils are a venue for dialogue around issues and opportunities where companies of all types and sizes can learn from each other.

All proposals to amend the *NACHA Operating Rules* are overseen and initially reviewed by NACHA's Rules and Operations Committee, which is composed of a representative sample of financial institutions (by size, type, geography, etc.) as well as representatives of Regional Payments Associations, the Network Operators, the Federal Reserve Board of Governors, and the U.S. Treasury Department. The Committee determines whether a rule proposal is warranted; if so, the proposal is assigned to a rules work group (itself composed of a similar representation) for research and development. A rules work group will obtain additional input on a proposed rule from Network users, technology and service providers, and other industry representatives. When a rules work group reports back to the Committee, the Committee determines whether the proposal will be issued publicly for comment.

NACHA accepts and reviews comments on a rules proposal from any party, from any type of organization. These comments are reviewed by both the rules work group and the Rules and Operations Committee in determining whether a proposed rule should be formally adopted. If so, the proposed rule is presented to the entire NACHA membership for balloting. Allowing for "request for information" and/or "request for comment" prior to a Rule ballot ensures that voices of many can be heard, and that up to date information can be considered before making a Rule.

NACHA's voting process on proposed rules contains checks and balances to ensure that proposals have broad-based support in order to be adopted, and to ensure that proposals with broad-based

support cannot be blocked by just a small number of members. First, all NACHA members have the right to vote on the Rules; this right is not limited to the NACHA Board of Directors, Rules and Operations Committee, or other limited representation of the membership. Second, to be formally approved as an amendment to the Rules, a proposal must be approved by either two-thirds of the votes cast or by two-thirds of the number of members voting. Third, because NACHA's Regional Payments Association members vote on the *Rules* directly, the voices of smaller, community banks and credit unions are significantly represented in the voting process, as these associations collectively serve over 10,700 member financial institutions.

As rules are being developed and especially once a ballot is approved, NACHA also supports a comprehensive framework for the delivery of education to audiences across the U.S., consisting of offerings it delivers at the national level, grassroots education conducted by its 18 Regional Payment Associations, and collaborative efforts it undertakes with other strategic partners. Education is a key component of effective rulemaking, as it ensures that full implications are understood. Topics range from focused, tactical instruction to broader, strategic topics.

Appendix 3 provides more information on the NACHA rulemaking process.

Operating Rules Work in Concert with Laws and Regulations

Since 1974, NACHA has successfully administered the *NACHA Operating Rules* by precisely defining the roles and responsibilities of financial institutions and other participants in the Network. The success of the ACH Network demonstrates the benefits and significance of private-sector rulemaking. The use of direct electronic payments – such as Direct Deposit, electronic bill payments, and business-to-business electronic payments – has tripled over the past 10 years, as the *Rules* have provided for innovation, interoperability, efficiency, security, and certainty for financial institutions, their customers, and governmental entities of all types.

The growth of the Network has been enabled through NACHA's inclusive rulemaking processes, as well as its close cooperation with a broad variety of industry participants, governmental agencies

and regulators. Consider a few ways in which the *NACHA Operating Rules* work in concert with applicable laws and regulations to provide a legal and business foundation for the use of electronic payments:

- The *Electronic Fund Transfer Act* (EFTA), the Federal Reserve Board’s Regulation E, and in some instances, the Federal Trade Commission’s *Telemarketing Sales Rule* afford protection for consumer ACH transactions. The *NACHA Operating Rules* parallel the *Telemarketing Sales Rule*, and in some instances exceed the consumer protections against unauthorized transactions provided by Regulation E. These protections compare favorably to those for check payments, and have been supported by consumer advocacy groups.
- Uniform Commercial Code Article 4A addresses the roles and responsibilities of parties to commercial credit transfers through the ACH Network. The *NACHA Operating Rules* incorporate the necessary provisions of UCC4A to cover business-to-business credit payments.
- The Treasury Department’s 31 CFR Part 210 formally adopts the *NACHA Operating Rules* to apply to the Federal government’s ACH payments, such as Social Security and other benefit payments by Direct Deposit to tens of millions of Americans, collections and disbursements to vendors, and Federal tax collections and refund payments.

As regulations change, the structure of the *NACHA Operating Rules* and formats allows for responsiveness to those changes. For example, the Treasury Department is in the process of adopting changes to how it codes Federal benefit payments (based on NACHA recommendations) to make these payments more readily identifiable to financial institutions complying with a garnishment order since such payments are generally exempt from garnishment.

NACHA Operating Rules: Lessons Learned – Balance and Adaptability

As the payments landscape has grown and evolved, so too, have the *NACHA Operating Rules*. Following more than three decades of administering the *Rules*, time and again, NACHA has

identified the themes of balance and adaptability as elements core to the evolution of the Network and the *Rules*.

- Balance is key – in both the operating rules themselves and the processes through which they are amended. Balancing is required for:
 - Risk versus innovation
 - Speed of rulemaking versus broad inclusiveness
 - Cost versus benefit
 - Inclusiveness of and impact on all types and sizes of participants

Operating rules allow for flexibility in balancing all of these trade-offs, especially the fine balance between risk and innovation where the assignment of roles, responsibilities, and recourse is key. NACHA’s rulemaking process has evolved over the years to incorporate changing Network participants, as well as to encourage faster adaptation of the Network. Previously, one process fit all rules. Today, there are categories for major, moderate, and minor rules, which mean that some rules can be adopted more quickly than others.

Because the *NACHA Operating Rules* are embraced by all financial institutions and their customers across the United States, NACHA has developed processes that lean on the side of inclusiveness. All member financial institutions, regardless of size, have a voice in rulemaking via their Regional Payment Association. Likewise, voting processes have also changed over time to establish checks and balances, with the “balance” of participants always the ultimate goal.

- Adaptability is required on many fronts. Adapting:
 - To new technology
 - To new standards
 - To new participants
 - Via the creation of venues for dialogue and education
 - As regulations change

Rules take time to develop and inclusiveness takes time, but the *NACHA Operating Rules* and NACHA also have learned to be flexible in adapting to changing needs and technology over time. The *Rules* have changed iteratively through the years as requirements change and needs evolve. Although Direct Deposit of payroll was the first Network application, it is now used for many other types of payments, such as expense reimbursements and other types of benefit payments.

As technology has changed and new opportunities arise more rapidly, NACHA has also developed an ability to utilize its *Rules* to support “op-in programs.” This mechanism allows certain parties to use the strength of the *Rules* to support their transactions, while not obligating all Network participants. It also provides a mechanism to try out new techniques and see results, before utilizing it across the whole Network. The adoption and use of XML by businesses in all aspects of the supply chain is a case in point where the ACH Network is recognizing new standards and allowing their use in the ACH Network. XML data elements were used in a “opt-in program” that has now become operational, and the ability to carry XML messages through the ACH Network in the same manner as EDI transactions sets is currently going through the *Rules* change process.

In addition, changes and updates to current standards – and often even new standards – may not require changes to operating rules. For example, changes to any of the many standards that govern the content and composition of paper checks – standards that cover everything to placement of information on the face of the check to paper thickness – rarely require that the rules of check clearinghouses be amended, as those rules largely govern relationships among the check-clearing parties. In the ACH Network, which has allowed conversion of paper checks to electronic items for a decade, changes in these standards over this time have not necessitated any *NACHA Operating Rules* revisions. In the rare event where a proposed standard revision – or a proposed new standard – might not be supported by current rules, standards bodies typically work closely with industry representatives to ensure that the resulting standard can and will be accommodated.

Over time, Network participants continue to change, and both NACHA and the *NACHA Operating Rules* have had to adapt to reflect new roles and responsibilities of different players in the Network. Various NACHA Councils have been created (and dispersed) over time to support dialogue for new ideas and issues, and as a venue to discuss and propose new ideas on rules, thereby further fostering innovation and discussion during early phases of a potential rule.

The *NACHA Operating Rules* have also changed over time to accommodate new Network participant roles. For example, there are a variety of ways that an employer can process its Direct Deposit transactions. It can process its payroll directly with its financial institution, or outsource part or all of its payroll function to a payroll processor. There are many choices available in the marketplace, and companies make choices based on their needs. The very fact that there are thousands of independent payroll service companies that offer Direct Deposit services strongly suggests that the Network is inclusive of many participants.

Rules directly have evolved to become better aligned with other regulations by being more adaptive over time. This minimizes potential conflict between the *NACHA Operating Rules* and regulations such as the Federal Reserve's Regulation E, streamlining enforcement as well as efficiency in terms of how to implement.

Applicability of “Lessons Learned” to Healthcare

1. Operating rules can drive efficiencies.

It is evident that healthcare reform can effectively utilize and enforce operating rules and standards to promote economies of scale for payment and other healthcare transactions. These transactions will need to be secure, and conform relative to syntactic and semantic definitions. Standards will help to define those areas of conformity. All players – providers, insurers, and financial institutions – can assist in the enforcement of standards and promote adoption. The operating rules themselves will facilitate the understanding of roles and responsibilities that will most directly simplify the

payment and remittance process. The rules require systemic solutions and data formatting for all participants which will facilitate the straight-through processing of all electronic transactions.

With the Federal government as a large user of the ACH Network, it was rapidly acknowledged that a national, not a regional system would provide the greatest efficiencies. The rapid evolution from regional compacts to national operating rules administered by a national entity eliminated multiple points of variations, enabled full interoperability, and drove participants to agree to common rules. Although difficult to engage all across the country, it can be done.

2. Start early and be adaptive.

The timeline outlined for administrative simplification in the *Patient Protection and Affordable Care Act* is very aggressive. Building upon what has already been created is a necessity, and starting those steps necessary to address all aspects of simplification will be important. Processes need to be iterative, flexible, and adaptive over time. With technology rapidly changing – raising opportunities as well as risk – it is fair to say that we cannot accurately predict the future. If necessary, “opt-in programs” can test technology as well as impact in an effective way before an operating rule is formally adopted or changed. *Rules* have provided us the flexibility to be adaptive of technology changes and user changes, with multiple enhancements to *Rules* each year. The inclusion of “guidelines” along with the *NACHA Operating Rules* has proven to be an excellent tool to provide further clarification to entities that need to implement the *Rules*. The *ACH Guidelines* provide specific information about the different ACH applications including best practices, implementation instructions, and some mapping requirements. The *ACH Guidelines* provide information similar in scope to some of the information contained within a single healthcare companion guide, thereby making it applicable to all participants utilizing the operating rules.

3. All processes need to be inclusive, and education is required.

Participants in financial services are as diverse as those in healthcare – spread across the United States, of various sizes, sophistication, and with various organizational and business requirements. Therefore, rulemaking processes can be inclusive and raise up opportunities for many voices to be

heard. Additionally, outreach via education and training is important, so that all parties fully understand their rights and responsibilities. Through work with the Regional Payment Associations, NACHA not only developed processes to hear the voice of many, but also has processes to train and educate many to foster understanding and compliance with applicable rules, regulations, and standards. Education and training also provides a venue for introduction of innovative solutions and technologies balanced with sound risk management, and an opportunity to understand, then develop, evolve, and adopt appropriate business practices. With mandatory changes in healthcare, education and outreach to all possible participants will be as important as the operating rules themselves.

NACHA as Industry and Government Partner

Clearly, one of NACHA's core competencies is in rulemaking and the success of the *NACHA Operating Rules*, recognized throughout the industry, has sparked ongoing collaboration and coordination with numerous public and private entities.

In one such combined government and industry collaboration, NACHA wrote and today administers the *QUEST*[®] *Operating Rules* for the delivery of card-based lifeline benefits like Temporary Assistance for Needy Families (TANF) and food stamps³. The creation of these rules required working with the States, the Federal government, and the private sector (card networks, processors, and financial institutions) to deliver private-sector electronic efficiencies to a paper-based system. NACHA developed these rules to ensure interoperability among programs and throughout many states, uniform acceptance and dispute resolution procedures, and increased awareness through the *QUEST*[®] mark. Forty-three states, the District of Columbia, Guam, and the U.S. Virgin Islands are now *QUEST*[®] signatories and operate through the rules. This adoption is testimony to an inclusive rulemaking process – bringing together disparate stakeholders to develop consensus and then drafting rules that appropriately assign rights and obligations of participants, while apportioning liability and incorporating applicable standards.

Although NACHA is a non-profit organization, the input from governmental entities has helped to ensure nationwide adoption and utilization of the *Rules* and the Network. Since its inception, NACHA has worked closely with the Federal government, and the ACH Network and the *NACHA Operating Rules* have been developed over time in collaboration with the Federal government and other governmental agencies. In 1974, the first set of operating rules were developed, and NACHA successfully negotiated with the Federal Reserve System to have these rules apply nationally. Also that year, the first true nationwide application was implemented on the Network – the Direct Deposit of the United States Air Force’s payroll. Today, the Federal Reserve and a private-sector organization – The Clearing House Payments Company – act as Network Operators, providing the technology capabilities for financial institutions to route their direct electronic payments to their proper destinations.

In addition, the Federal government is the largest user of the ACH Network, and current initiatives point to a continued increase in use. Specifically,

- In 2009, the Federal government initiated more than 1.2 billion payments in the Network, securely and efficiently passing almost \$4.3 trillion worth of value. The vast majority were Direct Deposit payments made to federal employees, retirees and beneficiaries.
- On April 19, 2010, the Federal government announced its all-electronic payments strategy, with the ACH Network as its cornerstone, to ensure that all Federal payroll, retirement, benefit and other disbursements are made electronically through Direct Deposit by March 2013. Estimated savings of more than \$400 million are expected in the first five years.
- The Federal government also uses the Network for Federal tax collections. In the 2009 fiscal year (October 1, 2008 – September 30, 2009), more than 100 million Federal tax payment transactions were processed through the Electronic Federal Tax Payment System, totaling \$1.9 trillion. More than 97 percent of U.S. employment taxes were paid electronically during the 2009 fiscal year, according to the U.S. Treasury Department.

These examples show only a sample of the collaborative work NACHA has done within and outside of the payments industry. NACHA has a proven track record of partnering with government and private-sector organizations in the development of rules and appropriate standards.

Conclusion

Private-sector rulemaking has provided significant benefits to all participants in ACH Network, and the benefits have grown over time. Benefits can and have accrued to consumers, small businesses, corporations, financial institutions, and governmental agencies.

There are meaningful parallels between the requirements of healthcare reform, and the efficiencies and cost savings obtained by using the ACH Network to process EFT payments and electronic remittances. The U.S. Department of Treasury's Financial Management Service (FMS) has released data that indicates that the Federal government saves \$0.925 for every ACH credit payment used instead of a check, which in 2009, means the Federal government experienced a \$1 billion cost savings by moving electronic. The implications for healthcare are vast.

Establishing operating rules and standards for automating healthcare transactions as provided in section 1104 of the *Patient Protection and Affordable Care Act* will drive efficiencies and significant cost reductions from four main sources: payment, streamlined enrollment, and centralized Provider preference management, efficient inquiry resolution, and accelerated electronic adoption. Achieving this goal requires stakeholders to work together, to take advantage of existing oversight, and to avoid redundancy.

NACHA clearly has expertise in rulemaking and standards, and we believe we are poised to apply our core competencies to the healthcare arena to ensure strong solutions. NACHA and its members believe that meaningful efficiencies and cost savings are obtainable in processing healthcare payments and electronic remittance advices by utilizing existing rulemaking processes and existing infrastructures and networks. The healthcare industry, along with support of financial institutions, can adopt operating rules that drive administrative efficiencies in healthcare.

Additional information about NACHA is available on our website at www.nacha.org. NACHA would be glad to answer any questions the Committee may have on the Network and our rulemaking processes.

Appendix 1

History of NACHA and ACH Network

The ACH Network was developed in response to the growth of check payments and the many technological advances in the 1970s, and functions as an efficient, electronic alternative to checks. The key objective was to replace paper checks and related information with a much more efficient alternative.

Pre-NACHA Development Work: The ACH movement began in the early 1970s when a group of California bankers formed the Special Committee on Paperless Entries (SCOPE). In direct response to the rapid growth in check volume, the Committee was chartered to explore the technical, operational, and legal framework necessary for an automated payments system.

SCOPE laid the groundwork for the first Automated Clearing House (ACH) association, which began operation in 1972. The establishment of this ACH association led to the formation of similar groups in other parts of the country. Agreements were made between the emerging regional ACH associations and the regional Federal Reserve Banks to provide facilities, equipment, and staff to operate regional ACH networks. Two notable exceptions to this type of arrangement occurred in New York and Chicago, where private clearing houses were formed to handle ACH transactions.

Milestones:

- 1974 The California ACH Association, the Georgia ACH Association, the New England ACH Association and the Upper Midwest ACH Association form NACHA within the American Bankers Association.
Nationwide ACH rules are approved.
USAF starts using the Network for Direct Deposit of payroll; program success results in the Treasury and Social Security accelerating plans to use Direct Deposit for Federal benefits.
- 1978 Nationwide network fully complete and operational; supports commercial payments in addition to Federal agency payments.
- 1985 NACHA becomes an independent organization.
- 1988 ACH payments exceed 1 billion.
- 1989 NACHA conducts its first Direct Deposit National Marketing campaign;
Forms first industry council—the Banker’s EDI Council.
- 1993 The Accredited ACH Professional (AAP) program begins.
- 1996 The *QUEST*[®] *Operating Rules* for Electronic Benefits Transfer approved.
- 1998 ACH Payments exceed 5 billion; the first e-check application—Represented Check Entry (RCK)—becomes effective.
- 2001 NACHA’s reorganization becomes effective—direct membership is re-opened for financial institutions.
- 2003 ACH payments exceed 10 billion; e-check payments exceed 1 billion.
- 2004 NACHA marks its 30th anniversary.
- 2009 ACH payments approximate 19 billion.
- 2010 Treasury, Social Security, VA, Railroad Retirement Board and others announce all-electronic benefits delivery using the Network to be fully effective March 2013.

NACHA Education & Training Services

NACHA supports a comprehensive framework for the delivery of education to target audiences across the U.S. and globally, consisting of offerings it delivers at the national level, grass roots education conducted by its 18 Regional Payments Associations (RPAs), and collaborative efforts it undertakes with other strategic partners. By partnering with RPAs, education, one-on-one training and audit services are made available across a wide geography to many more industry participants than would otherwise be possible. Education content ranges from broader, strategic topics to focused, tactical instruction depending on program and audience. Across these offerings is a common objective of educating providers, users, and regulators of electronic payment and information services with subject matter of the highest quality that is delivered consistently to foster:

- Understanding of and compliance with applicable rules, regulations, and standards
- Introduction of innovative solutions and technologies balanced with sound risk management
- Development, evolution, and adoption of appropriate business practices

Annual PAYMENTS Conference

NACHA's annual PAYMENTS Conference, recognized for its demonstrated thought leadership and quality, draws decision makers, innovators, implementers, and users from the private and public sector with a comprehensive program that spans the electronic payments field. With over 130 educational sessions ranging from hands-on work shops to strategic, forward-looking general sessions, PAYMENTS delivers delegates at every level of experience and from every perspective of the payments environment with subject matter that challenges, instructs, and can be applied to business processes. The PAYMENTS Conference also features a robust exhibit hall and forums for dialogue that highlight solutions and information sharing.

The Payments Institute (TPI)

The Payments Institute is an intensive five-day school that offers payments novices and veterans a deep dive into core and emerging subject matter. The curriculum is meticulously designed to enable the student to construct a path of educational building blocks, delivered via lecture, interactive classroom instruction, and group projects.

Teleseminars/Webinars

NACHA offers distance learning via telephone and web-based channels in partnership with its Regional Payments Associations. Subject matter instructs participants on the meaning, implications, and implementation of and compliance with amendments to the *NACHA Operating Rules*, risk management practices, research, legal and regulatory developments, and emerging topics of interest. NACHA also collaborates with other national associations and key entities to educate new and non-traditional audiences on relevant subjects.

Institute of International Payments

The Institute of International Payments delivers payments users and providers in the U.S. with intermediate to advanced-level education on international payments in a classroom setting. The curriculum encompasses the key principles, concepts, processes, infrastructures, best practices, and legal and regulatory issues in international payments. This unique learning experience is crafted to expand upon and enhance the delegate's existing knowledge of domestic payments concepts in an increasingly globalized world of commerce. This program is a part of an educational suite on global payments which also includes:

- *Principles of International Payments* — Introductory-level seminar held in conjunction with Regional Payments Associations at six locations across the country
- *Global Electronic Payments Conference* — Gathering of global payments strategists and executives from the Americas, Asia/Pacific, Africa and Europe

Accredited ACH Professional (AAP)

NACHA manages the Accredited ACH Professional (AAP) Program as national certification program for payments professionals. The credential, earned by over 3,500 professionals, demonstrates the bearer's expertise in the *NACHA Operating Rules*, the ACH Network, and the payments system as a whole. The accreditation is awarded through a robust annual examination process, and allows professionals to maintain accreditation through continuing education.

Publications

NACHA maintains a national publications program in corporation with its Regional Payments Association which offers a comprehensive selection of books and tools to support the understanding of and compliance with the *NACHA Operating Rules*, adoption of sound risk management practices, and the implementation and promotion of electronic payment and billing applications.

Regional Payments Associations

The 18 Regional Payments Associations of NACHA represent over 10,700 depository financial institutions including commercial and community banks, savings institutions, and credit unions, and affiliate companies in a specific region. In addition to programs conducted in collaboration with NACHA, the Regional Payments Associations offer education at the local level through regional conferences, seminars, workshops, boot camps, and distance learning. Through the Regional Payments Associations, education on topics related to the ACH Network, *NACHA Operating Rules*, and other payments system subjects is conducted at the grass-roots level.

Appendix 2

ACH Network and Healthcare Payment Processing

The potential benefits of processing healthcare payments and ERA through the ACH Network are significant. But the current lack of clarity in the marketplace around applied payment standards prevents fully leveraging existing banking infrastructure and settlement systems. The fact that limited Payer and Provider IT resources are not directed towards claims and payments system integration reflects this lack of clarity. Section 1104 of the *Patient Protection and Affordable Care Act* offers the opportunity to establish this clarity and the results should prove significant.

For its part, the ACH Network already serves as an efficient means for exchanging payments and ERA among Payers and Providers. NACHA's "CCD+" format permits the X12 820 and X12 835 transaction sets and the EFT payment to travel separately, with a "re-association key" placed in the CCD+ addenda record to link the two. Second, the "CTX" format permits either transaction set to travel with the EFT payment in the addenda record(s), and the financial institution delivers this data to the Provider. When Payers use the correct transfer formats, the Provider's financial institution can generate a deposit report (in a form with delivery means tailored between the financial institution and their customer) that lists the credited amounts and related information, thereby automating re-association of the payment with its ERA.

Given the opportunities available for automated reconciliation when the ACH transaction travels with, or travels separately from, the ERA, the labor-intensive manual process of reconciling payment with its associated remittance data can be eliminated. From the Provider's perspective, we anticipate this community would seek the ability for Providers to designate "EFT with" (e.g., CTX) or "EFT without" (e.g., CCD+) ERA included with the transaction under any contemplated operating rules.

Appendix 3

NACHA Rulemaking Process

1. Idea Submission: A member and other key parties can submit an idea for a rule amendment to NACHA staff. The idea is presented as an initial business case which describes the proposal and identifies the anticipated benefits and costs for ACH Network participants. A party that is not a direct member can submit an idea by working with a direct member to sponsor their idea.

2. Rules and Operations Committee Review: The Rules and Operations Committee will consider the idea for consistency with NACHA's strategic plan and other relevant reasons for accepting the idea. The Committee will either: 1) accept the proposal for development within the Rulemaking Process, 2) request additional information from the submitter, or 3) reject the proposal.

If the Rules and Operations Committee accepts the proposal, the Committee will designate the category of the proposed rule and assign it to a rules work group. The categories are: Category A, major impact to the ACH Network; Category B, moderate impact to the ACH Network; and Category C, minor impact to the ACH Network.

Examples of Category A changes include new ACH applications, major modifications to ACH software, and major modifications to the current Rules. Examples of Category B changes include modifications to existing ACH applications, regulatory changes, emergency changes and Board-driven directives, and moderate changes to ACH software and the existing Rules. Examples of Category C include editorial changes for grammar, spelling, and consistency, and clarifications of intent.

3. Request for Comment: All Category A and B proposals are issued for public comment in a manner similar to that used in rulemaking by Federal agencies. NACHA accepts comments from any interested party – financial institutions of all types and sizes, corporate users of the ACH Network, government agencies and regulators, payment processing and technology service companies, industry associations, Congressional offices, consumer advocates, etc. Requests for comment are publicly available on NACHA's web site during the comment period. Comment periods are open anywhere from 30-to-90 days depending on the nature of the proposal and its level of complexity.

Through this Request for Comment process, any interested participant in the ACH Network can have its voice heard. Financial institutions, including community banks and credit unions, can comment on rule proposals either directly or through their representatives at Regional Payment Associations or other industry associations (examples: Independent Community Bankers of America). Corporate users of the ACH Network can comment on rule proposals either directly or through representatives such as a NACHA council, other industry associations (examples: Association of Financial Professionals, American Payroll Association), or even through their own financial institutions.

4. Final Review: NACHA, the Rules and Operations Committee, and any rules work groups review and consider all comments in determining whether a proposed rule should be recommended for implementation. After reviewing comments, the Rules and Operations Committee can determine that a proposal should be: 1) balloted as originally proposed; 2) balloted with some modifications; 3) modified and re-issued for public comment; or 4) rejected.

5. Balloting: For any rule proposal that the Rules and Operations Committee approves to be balloted, NACHA issues a ballot to its direct membership. NACHA's voting process on proposed rules contains checks and balances to ensure that proposals have broad-based support in order to be adopted, and to ensure that proposals with broad-based support cannot be blocked by just a small number of members. First, all NACHA members have the right to vote on the Rules; this right is not limited to the NACHA Board of Directors, Rules and Operations Committee, or other limited representation of the membership. Second, to be formally approved as an amendment to the Rules, a proposal must be approved by either two-thirds of the votes cast or by two-thirds of the number of members voting. Third, because NACHA's Regional Payments Association members vote on the Rules directly, the voices of smaller, community banks and credit unions are significantly represented in the voting process, as these associations collectively serve over 11,000 financial institutions.

ACH Network Legal Framework

The ACH Network operates from beginning to end through a series of legal agreements amongst Network participants (see below for a definition of participants). Before any transaction is initiated, the Originator and ODFI execute an agreement to use the ACH Network to originate payments. Among other things, the agreement should bind the originating company to the *NACHA Operating Rules*, define the parameters of the relationship between the two parties, identify processing requirements for the specific application(s) to include specific usage of the ACH formats and the adoption of relevant industry standards, and establish liability and accountability.

While the *NACHA Operating Rules* are the primary document addressing the rules and regulations for the commercial ACH Network, Federal government ACH payments are controlled by the provisions of Title 31 Code of Federal Regulations Part 210 (31 CFR. Part 210). The Financial Management Service (FMS) of the U.S. Department of the Treasury is the agency responsible for establishing Federal government ACH policy. In 1999, 31 CFR Part 210 was revised by FMS to adopt the provisions of the *NACHA Operating Rules* as the regulations governing the transmission and receipt of Federal government ACH entries, with certain exemptions to address matters of Federal law. FMS also publishes The Green Book, a procedural manual for Federal government ACH payments.

Other laws that have a direct bearing on ACH operations include:

- The Uniform Commercial Code (UCC) Articles 3 and 4, which govern check transactions;
- UCC Article 4A, which governs wholesale credit transfers; and,

- The Electronic Funds Transfer Act as implemented by Regulation E.

Certain other activities related to ACH payments are affected by the Federal Trade Commission's Telemarketing Sales Rule, The Right to Financial Privacy Act, Regulation D regarding reserve requirements, Regulation CC regarding funds availability, and other regulatory agency directives.

Agreements are also required between RDFIs and the ACH Network Operators for Operator services. Relationships between the consumer as Receiver and the RDFI are generally governed by Regulation E and the *NACHA Operating Rules*. In some cases, other agreements exist between the RDFI and the Receiver, particularly if the Receiver is a corporate or government entity.

Typically, six participants are involved in an ACH transaction:

1. The Originator is usually a company directing a transfer of funds to or from a consumer's or another company's account.
2. The Originating Depository Financial Institution (ODFI) is the financial institution that receives payment instructions from Originators and forwards the entries to a Network Operator.
3. An ACH Network Operator is the central clearing facility operated by a private organization or a Federal Reserve Bank on behalf of depository financial institutions, to or from which participating institutions transmit or receive ACH entries.
4. The Receiving Depository Financial Institution (RDFI) is the institution that receives ACH entries from the Network Operator and posts the entries to the accounts of its depositors (Receivers).
5. A Receiver is a person or an organization that has authorized an Originator to initiate an ACH entry to the Receiver's account with the RDFI. A Receiver may be either a company or a consumer, depending on the type of transaction.
6. Processors and software provider facilitate the utilization of the Network by various participants – they enable robust solutions that not only pass the payment, but also pass the associated information – and allow “reach” of the Network to all consumers, businesses, financial institutions, and governmental agencies.

Participants in the Network use the latest technology to achieve efficient and reliable payment processing. Companies, financial institutions and Network Operators are linked together by secure telecommunications connections. All direct electronic payment files are delivered by electronic transmission, and processing by financial institutions and Network Operators is automated. The Network's ability to pass significant information, along with the payment, distinguishes it amongst other forms of electronic payments. Both Network Operators, through which all financial institutions route ACH transactions, have tools available to help financial institutions “translate” payment and remittance information into secure human-readable reports or posting files. These inexpensive services are especially helpful for all Network participants, as many financial institutions can then offer the service, and that volume helps to drive costs down.

Financial institutions of all types and sizes enable their customers to initiate payments on their

desktop computers and connect to the financial institutions via secure web sites. The technology supporting all participants and their unique businesses is created by hundreds of organizations developing software programs or processing services to help deliver and manage various aspects of the payment and information.

Endnotes

¹ XML – Extensible Markup Language. A universal file format for storing and exchanging structured data.

² ISO 20022 - Universal financial industry message scheme that is based on a business modeling approach that allows users and developers to represent financial business processes and underlying transactions in a formal but syntax-independent notation. They can be converted into physical messages in the desired syntax. The first edition of ISO 20022 proposes a standardized XML-based syntax for messages.

³ The 1996 Federal welfare act required states to develop Electronic Benefits Transfer (EBT) systems to distribute TANF and food stamp benefits by January 1, 2002.