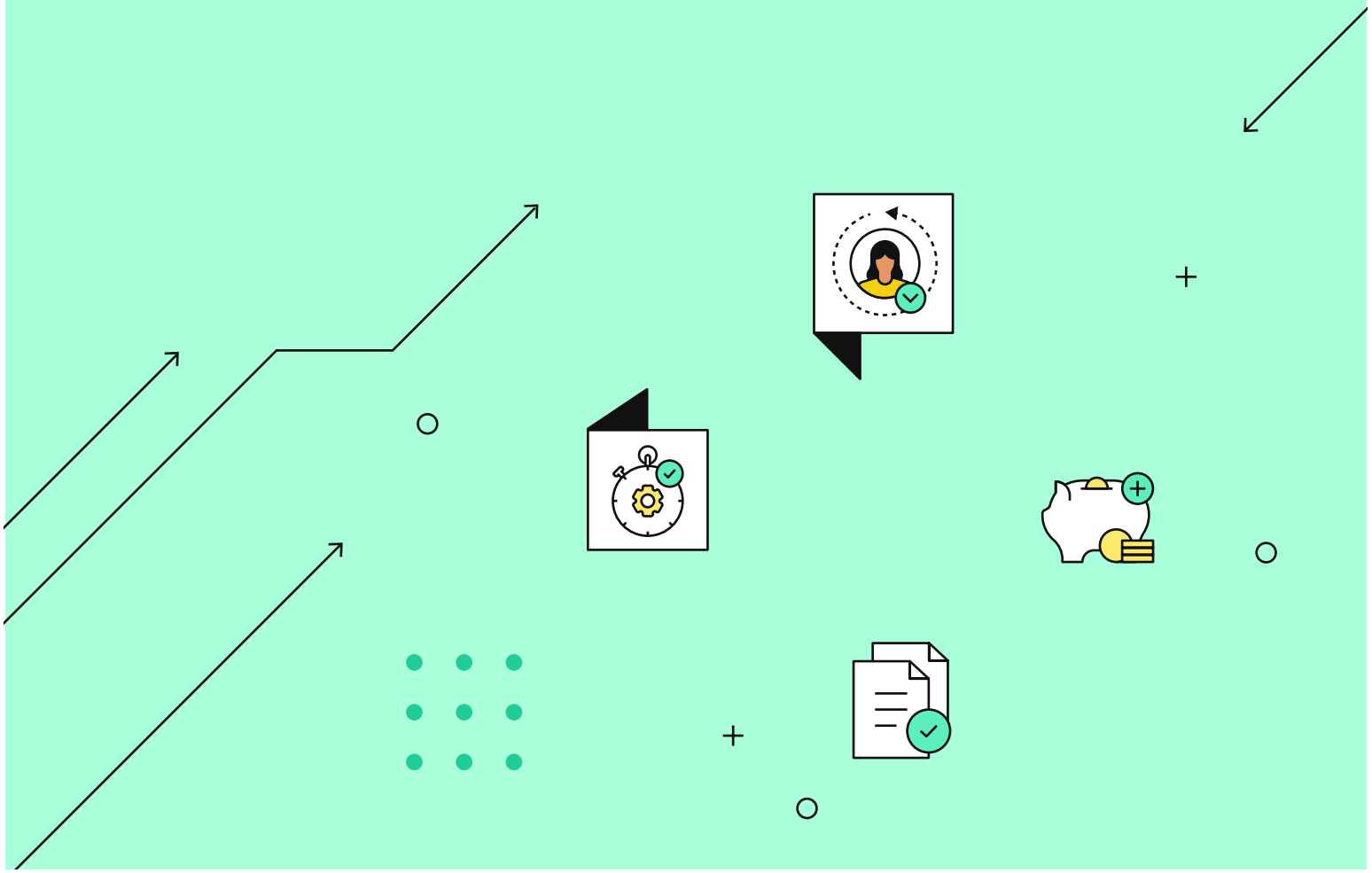
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ACH return codes: What they mean and how to minimize risk

Understanding ACH return codes is crucial to leveraging this fast-growing payment method. Learn what these codes mean and how to protect your company.



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Introduction

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Between 2020 and 2021, ACH grew to a total of 29.1 billion payments.

ACH (Automated Clearing House) payment volume has increased dramatically in recent years. Between 2020 and 2021, ACH grew by 8.7% to a total of 29.1 billion payments. Much of this growth was driven by peer-to-peer platforms and same-day ACH payments.

This is great news for businesses, especially those in fintech, looking to lower costs and improve the customer experience. ACH payments are easy to process, preferred by many consumers, and offer lower processing fees than credit cards.

There is one looming challenge with ACH payments, however—ACH returns. Returns of ACH payments can be confusing, create a cost center (rather than a growth lever), and negatively impact customer experience.

To reap the benefits of ACH payments, companies must understand what ACH return codes mean and the key factors that indicate a return is likely.

What are ACH returns?

ACH returns occur when an ACH payment cannot be completed for any reason, or when the payment initially settles but is rejected later. Essentially, it's the ACH payment equivalent of a bounced check. Common causes of ACH returns include insufficient funds, incorrect account information, fraud, errors, or if the account owner asks their bank to place a stop payment on the transfer.

Similar to bounced checks, there are fees and risks involved in ACH returns. For starters, ACH returns typically cost between $2 and $5, depending on the ACH processor. An end user may incur fees from their bank if an ACH transaction is returned due to insufficient funds or results in an overdraft to the bank account.

Another risk can result if the entity collecting a payment "fronts" or gives credit to the end user (such as when a new account is funded) before the ACH transaction settles. This is a common practice because ACH transactions can take anywhere from hours to days to settle.

If that money is later returned, the merchant is out for the amount of the transaction as well as the return fee. Companies selling physical goods or services may deliver purchases in good faith, only to be left unpaid if the ACH transaction is returned.

Still, the benefits of ACH generally outweigh the risks. Offering ACH payments provides customers with the option to use the payment process that works best for them. Many consumers prefer ACH payments and merchants often tie ACH payments to rewards programs so they can pass back some of their lower payment processing costs to customers while boosting loyalty.

Another benefit is reducing unintentional churn. The standard credit card is valid for just two to five years, while bank accounts are often used for decades. Because of that, companies using ACH for recurring payments are less likely to experience payment churn than those that use credit cards.

ACH payment benefits



Lower processing fees



Reduces customer churn



Better customer experience



Faster processing time

Bank-initiated returns vs. customer-initiated returns

The difference between customer-initiated returns and bank-initiated returns is who sends the return. For example, if the customer says they didn't approve a payment, that would result in a customer-initiated return. If there are insufficient funds in the account, that would be considered a bank-initiated return.

In both cases, the merchant will be charged a return fee between $2 and $5.

ACH return codes list

ACH return codes make it easier for originating and receiving financial institutions to communicate payment failures by explaining why they occurred and who initiated the return. The following list includes the most common types of ACH return codes, who initiates them, and how long they may take to be sent.

Understanding who initiates the code is important due to how long the payment may take to be returned. Bank-initiated codes are generally returned in two to three days while customer-initiated codes can take 60 days or longer.

Customer-initiated return codes

Customer-initiated return codes are sent when the customer takes action to cancel or revoke an ACH transaction from their account. Depending on the reason for the return, customers may have up to 60 days from settlement to refute an ACH payment. Common return codes in this category include:

ACH return codes	Cause	Time frame
R05	Unauthorized consumer debit using corporate SEC code	60 calendar days
R07	Customer revoked authorization (i.e. customer originally gave authorization then took it back)	60 calendar days
R10	Unknown originator and/or unauthorized to debit receiver's account	60 calendar days
R11	Customer states debit is not within authorization terms (e.g. charged too early or too much)	60 calendar days
R29	Corporate customer states debit is unauthorized	2 business days

Bank-initiated ACH return codes

Bank-initiated ACH return codes occur when the bank cannot process or accept an ACH transaction for some reason. In most cases, these codes are sent within a few business days. Common bank-initiated return codes include:

ACH return codes	Cause	Time frame
R01	Insufficient funds	2 business days
R02	Account closed	2 business days
R03	Unable to locate account/no account	2 business days
R04	Invalid account number	2 business days
R06	Originating Depository Financial Institution (ODFI) requested return	Not defined
R08	Payment stopped	2 business days
R09	Uncollected funds	2 business days
R13	Invalid ACH routing number	Next file delivery time after processing
R16	Account frozen	2 business days
R17	Suspicious entry with invalid account number or return of improper reversal	2 business days
R20	Non-transaction account	2 business days
R23	Receiver refused credit	Upon receipt of refusal

Less common ACH return codes

These return codes are less common and can be initiated by either the customer or the bank, depending on the situation. These codes are generally returned quickly but can be initiated after a longer period in some cases.

ACH return codes	Cause	Time frame
R12	Account sold to another Depository Financial Institution (DFI)	2 business days
R24	Duplicate entry	2 business days
R35	Improper debit	Next file delivery time after processing

Note: All codes shown in table are bank-initiated.

ACH risk management: How to reduce the risk of ACH returns

ACH is a convenient, affordable way for consumers and businesses to exchange money. However, it's not without risks. Similar to other digital transactions, ACH presents a risk of fraud and data breaches that can result in financial losses. The steps below will help limit risk exposure as ACH adoption grows.

37%

37% of ACH payments were impacted by fraud activity in 2021.[1]

How to reduce the risk of ACH fraud
37% of ACH payments were impacted by fraud activity in 2021



1. AI-powered ACH risk scoring



2. Follow Nacha guidelines



3. Use digital identity verification



4. Offer instant account verification

Source: jpmorgan.com

ACH risk scoring

One of the most effective methods to mitigate ACH risk is using AI-powered ACH risk platforms to better understand the risk of ACH returns. Plaid's Signal platform works in real-time to indicate the risk of bank and customer-initiated returns and flag high-risk ACH transactions before they are processed.

Businesses can set customized risk profiles based on their customers or industry. Using Plaid Signal can help reduce fraud and lower return risk by as much as 50%, allowing businesses to scale their ACH offering while managing risk.

1 jpmorgan.com

Follow Nacha guidelines

Nacha is an independent organization responsible for administering the ACH network, enforcing guidelines related to ACH payments, and driving the adoption of ACH systems. Their risk management team has developed guidelines and resources to aid in preventing ACH fraud, including a portal of risk databases, current threats, and guidance on adhering to regulations. Learn more about staying up to date with Nacha rules.

Implement digital identity verification

Plaid IDV (identity verification) is a fast, secure method for verifying customer identity online. Using dozens of data points and even government ID uploads, IDV helps ensure customers are who they say they are, which reduces the risk of all types of fraud, including those that come from customer-initiated ACH returns.

Use instant account verification vs. manual

Instant account verification uses an API to directly connect to a user's bank accounts to verify the account is active and in good standing. This allows companies to set up frictionless ACH payments in seconds, rather than hoping users enter the information correctly and waiting for ACH return codes to indicate an issue.

Unlike manual verification, this can be done in seconds right from a user's phone or computer, reducing the risk of ACH returns and improving payment security.

As ACH usage increases, understanding ACH returns is critical

While the rate of ACH fraud is relatively low, the mass adoption of P2P payments and consistent growth of instant ACH has increased the risk in recent years. Organizations looking to increase ACH offerings—or those seeing usage rates skyrocket—must take steps to secure their revenue and prevent fraud.

Reducing the risk of returns and fraud starts by following Nacha guidelines and leveraging new technology like instant account verification and IDV. However, the most effective way to prevent ACH returns and fraud is by catching returns before they occur through ACH risk scoring. By understanding the signs of a potential ACH return before a transaction completes, businesses can protect their bottom line and reduce fraud while leaning into this growing payment sector.

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