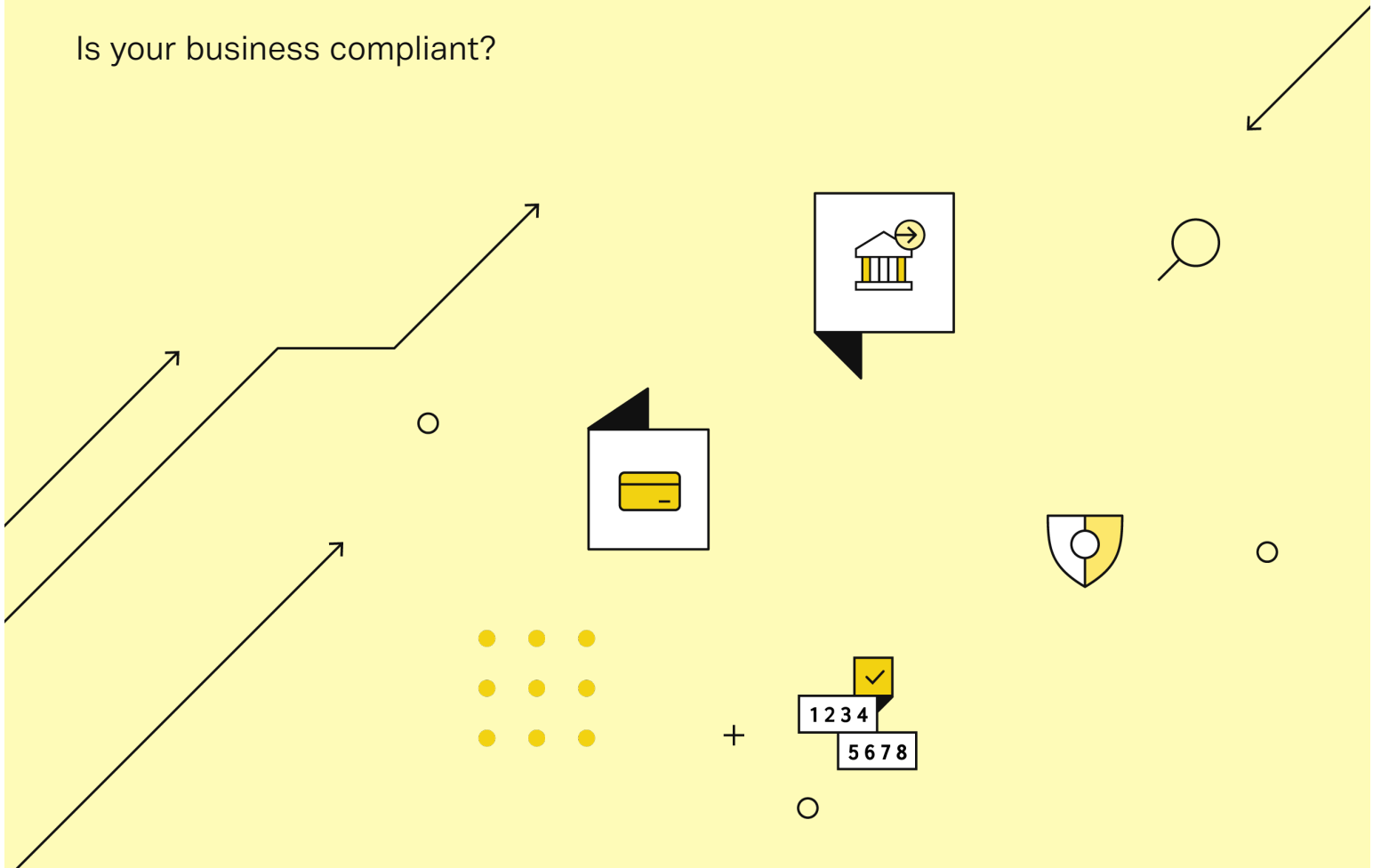# Nacha's 2021 account validation rule

Is your business compliant?

Nacha's 2021 account validation rule: Is your business compliant?

Companies that accept ACH payments over the web are now subject to more heightened validation requirements. However, this change can present an opportunity for businesses.

15%

Internet-initiated ACH transactions grew with a 15% volume increase in 2020

Online ACH volume is growing fast

The volume of online ACH payments is quite large and growing fast. ACH has long been a staple for larger, more regular payments—such as Direct Deposit wages and Direct Payment of utility bills—but its prevalence in other, smaller transactions is on the rise.

Much of this growth has come from internet-initiated ACH transactions, also referred to as WEB debits. There are many types of ACH transfers that happen online—mainly payments for bills such as mortgages, credit cards, and utilities, but also some high-ticket retail goods.

As a whole, ACH transactions volume grew by 8.2% in 2020, with 26.8 billion transactions totaling $61.9 trillion in value for the year. Internet-initiated ACH transactions grew even faster than overall ACH growth with a 15% volume increase in 2020.

ACH ON THE RISE IN 2020

61.9T	Value of all transactions in 2020
10.8%	Growth in total value over 2019
15%	Growth in internet-initiated payments volume, with 7.7B transactions

Source: Nacha

As transaction volumes rise, Nacha, the organization that governs the ACH system, has decided to implement a new rule, known as the Web Debit Account Validation Rule, that affects those who accept internet-initiated ACH payments. This rule adds on to the existing screening requirements that account validation (checking that account information is accurate and eligible for ACH transfers) should be included as part of a reasonable fraudulent detection system. It's goal is to ensure the continued quality and security of the ACH network.

In this whitepaper, we'll answer the most pressing questions surrounding this topic, provide insight on how to best meet the new rule, and how to use this change as an opportunity for growth:

- What is Nacha's 2021 rule change?
- Why is Nacha changing the rules?
- Are your payments compliant and what do you need to change?
- How do you effectively validate accounts?
- The problems with some account validation methods
- How instant account verification efficiently satisfies the rule change
- The future of online ACH payments

What is Nacha's 2021 rule change, exactly?

Nacha's 2021 rule change is specific to WEB debits (internet-initiated transactions) and increases the standards for detecting fraud. Specifically, ACH originators of WEB debits now must use a "commercially reasonable fraudulent detection system" that includes "account validation" for the first time use of an account number or for any change to previous account numbers. Previously, account validation had not been part of the fraud requirement, but this rule changes that.

Businesses that use ACH to debit consumer accounts via online/ mobile requests must validate that new accounts are legitimate, open, and able to receive an ACH transfer before their first use.

At a minimum, businesses that use ACH to debit consumer accounts via online/ mobile requests must validate that new accounts are legitimate, open, and able to receive an ACH transfer before their first use. Nacha does not recommend any specific method for validating account information, but there are several ways to achieve this, including microdeposits, manual validation, database verification, and instant verification via API—all of which we'll cover in more detail later on.

Originally the rule was going to take effect on January 1, 2020, but was pushed back to March 19, 2021, in order to give more time for guidance and education. The rule only applies to new accounts; already established accounts do not need to be re-validated. Additionally, originators are only required to validate the account information, not ownership.

Why did they change the rules?

This rule change is actually part of a larger, ongoing effort to address fraud attempts and data quality. It aims to do so by ensuring accounts are valid and by eliminating data entry errors related to account numbers, bringing to the forefront a requirement that has been in the Nacha guidelines for many years.

ACH fraud is relatively rare. In fact, it has the lowest fraud rate by value among all payment types, at 0.08 basis points ($0.08 of fraud per $10,000 in payments), according to a Federal Reserve study that measured fraud rates from 2012-2015. By comparison, ATM and card payments fraud increased from 7.99 to 10.80 basis points during the same time period.

However, the proliferation of ACH in fast-growing services—such as digital wallets and neobanks—underscores the industry's need to use commercially reasonable practices to ensure the continued safety of the ACH Network. These internet-initiated transactions (which grew by 15% in 2020) can potentially give fraudsters the opportunity to use stolen information to load funds and pay for goods and services. This is why now, more than ever, account validation is a necessary and reasonable requirement to help prevent fraud.

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Are your payments compliant?

With the new rule in effect, the way that many businesses had accepted ACH payments in the past will no longer be possible. This includes businesses that simply ask customers to manually enter their account and routing numbers, but don't validate those accounts.

Without the minimum step of making sure that the account is valid, open, and able to receive an ACH transfer, a business will not be in compliance with the new rule. However, businesses should keep in mind that the new rule does not affect existing customers that pay by ACH. It is only for new accounts or for those that have changed their bank account information via an online/mobile means.

There are several options for businesses to validate new accounts, and some are more efficient than others.

How do you effectively validate accounts?

The five approaches to validating accounts:

1 Manual validation

2 Microdeposits

3 Pre-notes

4 Database verification

5 Instant account verification

Under the new rule, there are five different approaches to validating accounts. These different approaches have a wide range in terms of speed, accuracy, and user experience.

1 **Manual validation** requires obtaining a customer's voided check to manually validate account and routing information. Businesses can also directly contact their customer's bank to validate this information. This method takes up to six days and is the most labor-intensive and high-friction way to validate accounts.

2 **Microdeposits** involve two steps. After a customer provides their account and routing numbers, businesses make one or two very small deposits (typically less than $0.05) into a customer's account. Then, the customer confirms the exact amount deposited to validate their account. This can take from a few hours up to 2-3 days, which creates some friction that can lead customers to potentially drop off and fail to validate their accounts.

3 **Pre-notes** (pre-notification transactions) are essentially the same as microdeposits, but they don't require the customer to confirm the amount deposited. Instead of sending a microdeposit, the business sends a $0 ACH transaction to validate the account information. This process takes
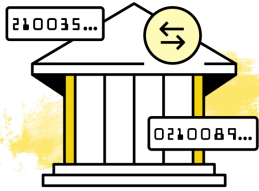
2-3 days, but customers can't initiate payments using pre-notes during this time. That's because Nacha rules don't let businesses give instructions to move funds until after a three business day waiting period when using this method, unless corrected information was provided by the receiving financial institution earlier.

4   Database verification uses a database that's shared by a consortium of banks to cross-reference and validate the account and routing numbers that people provide. In most cases, this method can verify that the account does indeed exist, but it doesn't verify ownership of the account. This leaves room for fraud and costly errors from people manually entering the wrong account and routing numbers. This method is fast, but another downside is that these databases are not updated in real time, so the information that's being validated could very well be outdated.

5   Instant account verification is the fastest and most frictionless way for users to validate their accounts. It uses application program interfaces (APIs) and secure bank connections to retrieve account and routing numbers directly from the accounts being validated. Using this method, users select their financial institutions from a list, enter their username and password, and are quickly connected—often in just a few seconds. This is the only verification method that uses a bank account username and password, rather than account and routing numbers, which is typically much easier to remember. The APIs used to instantly verify accounts can also retrieve other useful information such as account balances, identity verification, and transactions history—which opens up a new realm of possible financial services beyond instantly verifying accounts.

ACCOUNT VALIDATION METHODS

Validation method	Time required	Customer experience	Name verification	Visibility into account balance	Account/routing numbers shielded
Microdeposits	2–3 days	Poor	No	No	No
Manual validation	Up to 6 days	Poor	No	No	No
Pre-notes	3–10 days	Fair	No	No	No
Database verifcation	Seconds	Good	No	No	No
Instant account verification	Seconds	Good	Yes (Optional)	Yes	Yes (Optional)

The problems with some account validation methods

While some account validation methods may be less expensive than others, they come with hefty disadvantages. Many companies that choose these cheaper methods will suffer in the long run from numerous issues that can negatively impact the bottom line.

- **Delays.** In an era where consumers expect payments (along with many other services) to happen instantly, delays can destroy the user experience. With microdeposits potentially taking days and pre-notes taking 3 business days , new users will be waiting an uncomfortable amount of time—causing one of their first experiences with a brand to be a poor one.

- **Drop off.** The natural consequence of delays is customer drop off. While waiting for slower account validation methods to complete, many customers will simply abandon the onboarding process and either go elsewhere for the same service or forget that they signed up in the first place. Another opportunity for drop off is the friction that retrieving account and routing numbers causes, as most people do not memorize this information, unlike their bank account username and password.

- **Opacity**. Validation methods like pre-notes, microdeposits, and database verification simply verify that the account exists, and nothing else. Other important information, including the account balance, is missing. This increases the risk for failed transactions and NSF/overdraft fees; and can even cause removal from the ACH network if too many transactions fail.

- **Static databases.** After instant account verification, database verification is the next fastest option. But unlike the APIs that instant verification relies on, these databases are not automatically updated when customer account information changes. That means that at any given time, a certain percentage of the database is going to be incorrect, which will increase errors compared to instant verification.

How instant verification efficiently meets the 2021 rule change

At Plaid, our mission is to unlock financial freedom for everyone. That's why we've built an instant verification tool that enables people to easily connect their financial data to apps and services that they want to use; as well as help organizations easily comply with Nacha's new account validation rule.

To validate an account using Plaid, users simply select their financial institution from a list and enter the username and password associated with that account. Plaid connects to more than 11,000 financial institutions around the world— often in a matter of seconds.

$200M	Over 200 million US financial accounts have been linked with Plaid
5,000+	More than 5,000 apps and services are built using Plaid
7s	Plaid allows users to verify an account in as little as 7 seconds

Compared to other account validation methods, Plaid's instant verification tool provides businesses with three distinct advantages:

3.2x

After switching to Plaid, the digital bank Chime saw 3.2x higher conversion rates

1 **Higher conversion rates and more funded accounts.** Fast and reliable account verification leaves less room for customer drop off and provides a better user experience, which means that more customers will complete onboarding and account funding flows. Additionally, it's easier for people to remember their bank account username and password compared to their account and routing numbers, which makes them more likely to convert. After switching to Plaid, the digital bank Chime saw 3.2x higher conversion rates, as well as new customers adding 5x more funds to their accounts.

2 **Real-time data.** Plaid's API retrieves up-to-date account information in real time. That means the information provided by Plaid's instant verification tool is more reliable than any other method, including database verification that relies on a static database that's not updated automatically when account information changes.

3 **Differentiated data.** Plaid can retrieve more than just account and routing numbers; it can also get real-time account balance and identity information. Balance checks can verify that there are enough funds in an account before

$75,000

Metal, a cryptocurrency payments platform, used the identity data provided by Plaid to reduce fraud by $75,000 in one month

a transfer and identity checks can verify things like customer name and address. These additional data points can go a long way towards reducing the risks of fraud, ACH returns, and NSF/overdraft fees.

The personal finance app Qapital uses Plaid not only to connect new accounts, but also check balances before bank transfers to ensure that users have enough funds. To date, they have saved their users over $2.7 million in NSF/overdraft fees with Plaid.

Metal, a cryptocurrency payments platform, saw the potential in using Plaid for both onboarding new users and reducing fraud. Not only were they able to onboard new users in as little as 7 seconds, but they also used the identity data provided by Plaid to reduce fraud by $75,000 in one month.

The future of online ACH payments

In 2020, there was tremendous growth in the volume of internet-initiated ACH transfers, as well as ACH transfers overall. Nacha's new rule may require many businesses to implement changes to their onboarding flows, but those changes represent an opportunity for growth. With the uptick in ACH use, businesses that use this rule change as a chance to implement better customer onboarding and payments experiences should expect to see more paying customers.

From faster onboarding to enhanced fraud mitigation, meeting Nacha's 2021 rule with instant verification provides an opportunity for businesses to improve their customer experience in a myriad of ways. This is not just a call for compliance, but a chance to improve the bottom line with better conversion rates and more funded accounts.

With instant verification, onboarding customers to ACH will be more reliable, safe, and faster than ever—all while going above and beyond to meet the requirements for Nacha's new account validation rule.

PLAID

Plaid is a technology platform that enables applications to connect with users' bank accounts. We focus on lowering the barriers to entry in financial services by making it easier and safer to use financial data.