No. 23-1148(L)

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

STUDCO BUILDING SYSTEMS US, LLC,
Plaintiff-Appellee,

v.

1ST ADVANTAGE FEDERAL CREDIT UNION,
Defendant-Appellant.

On appeal from the United States District Court for the Eastern District of Virginia at Norfolk (2:20-cv-00417-RAJ-LRL)

BRIEF OF THE VIRGINIA CREDIT UNION LEAGUE, THE NATIONAL ASSOCIATION OF FEDERALLY-INSURED CREDIT UNIONS, AND THE CREDIT UNION NATIONAL ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF DEFENDANT-APPELLANT AND REVERSAL

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October 17, 2023

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

DISCLOSURE STATEMENT

- In civil, agency, bankruptcy, and mandamus cases, a disclosure statement must be filed by **all** parties, with the following exceptions: (1) the United States is not required to file a disclosure statement; (2) an indigent party is not required to file a disclosure statement; and (3) a state or local government is not required to file a disclosure statement in pro se cases. (All parties to the action in the district court are considered parties to a mandamus case.)
- In criminal and post-conviction cases, a corporate defendant must file a disclosure statement.
- In criminal cases, the United States must file a disclosure statement if there was an organizational victim of the alleged criminal activity. (See question 7.)
- Any corporate amicus curiae must file a disclosure statement.
- Counsel has a continuing duty to update the disclosure statement.

No. 23-1148 Caption: STUDCO BUILDING SYSTEMS v. 1ST ADVANTAGE

Pursuant to FRAP 26.1 and Local Rule 26.1,

Credit Union National Association
(name of party/amicus)

who is amicus, makes the following disclosure:
(appellant/appellee/petitioner/respondent/amicus/intervenor)

1. Is party/amicus a publicly held corporation or other publicly held entity? ☐YES ☑NO

2. Does party/amicus have any parent corporations? ☐YES ☑NO
If yes, identify all parent corporations, including all generations of parent corporations:

3. Is 10% or more of the stock of a party/amicus owned by a publicly held corporation or other publicly held entity? ☐YES ☑NO
If yes, identify all such owners:

4. Is there any other publicly held corporation or other publicly held entity that has a direct financial interest in the outcome of the litigation? ☐YES ☑NO
If yes, identify entity and nature of interest:

5. Is party a trade association? (amici curiae do not complete this question) ☐YES ☐NO
If yes, identify any publicly held member whose stock or equity value could be affected substantially by the outcome of the proceeding or whose claims the trade association is pursuing in a representative capacity, or state that there is no such member:

6. Does this case arise out of a bankruptcy proceeding? ☐YES ☑NO
If yes, the debtor, the trustee, or the appellant (if neither the debtor nor the trustee is a party) must list (1) the members of any creditors' committee, (2) each debtor (if not in the caption), and (3) if a debtor is a corporation, the parent corporation and any publicly held corporation that owns 10% or more of the stock of the debtor.

7. Is this a criminal case in which there was an organizational victim? ☐YES ☑NO
If yes, the United States, absent good cause shown, must list (1) each organizational victim of the criminal activity and (2) if an organizational victim is a corporation, the parent corporation and any publicly held corporation that owns 10% or more of the stock of victim, to the extent that information can be obtained through due diligence.

Signature: Trevor S. Cox Date: October 17, 2023

Counsel for: Credit Union National Association

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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No. 23-1148 Caption: STUDCO BUILDING SYSTEMS v. 1ST ADVANTAGE

Pursuant to FRAP 26.1 and Local Rule 26.1,

National Association of Federally-Insured Credit Unions
(name of party/amicus)

who is amicus, makes the following disclosure:
(appellant/appellee/petitioner/respondent/amicus/intervenor)

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Signature: Trevor S. Cox Date: October 17, 2023

Counsel for: Nat'l Ass'n of Federally-Insured Credit Unions

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No. 23-1148 Caption: STUDCO BUILDING SYSTEMS v. 1ST ADVANTAGE

Pursuant to FRAP 26.1 and Local Rule 26.1,

Virginia Credit Union League
(name of party/amicus)

who is amicus, makes the following disclosure:
(appellant/appellee/petitioner/respondent/amicus/intervenor)

1. Is party/amicus a publicly held corporation or other publicly held entity? ☐YES ☑NO

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Signature: Trevor S. Cox Date: October 17, 2023

Counsel for: Virginia Credit Union League

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INTERESTS OF *AMICI CURIAE*[1]

The Virginia Credit Union League (the "League") is a trade association that represents Virginia's 104 not-for-profit, member-owned credit unions, which serve over 18 million members worldwide. The League has helped to build, shape, and protect the credit union system in Virginia for almost 90 years. It advocates for its members at the state and federal levels, provides valuable compliance resources, and connects its member credit unions with business solutions to help them provide essential financial services to their own members. The League monitors emerging issues that affect Virginia's credit unions and, when needed, takes action to protect credit unions and their members.

The National Association of Federally-Insured Credit Unions ("NAFCU") advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 137 million consumers with personal and small business financial service products. It provides members with representation, information, education, and assistance to meet the constant challenges that cooperative financial institutions face in today's economic environment. NAFCU proudly represents many smaller

[1] *Amici curiae* file this brief with the consent of all parties under Federal Rule of Appellate Procedure 29(a)(2). No party or its counsel, or any other person other than *amici* and their counsel, authored this brief in whole or in part, or contributed money that was intended to fund preparing or submitting this brief. *See* Fed. R. App. P. 29(a)(4)(E).

credit unions with relatively limited operations, as well as many of the largest and most sophisticated credit unions in the Nation. NAFCU represents 78 percent of total federal credit union assets and 62 percent of all federally-insured credit union assets.

The Credit Union National Association ("CUNA") is the largest trade association in the United States serving America's credit unions and the only national association representing the entire credit union movement. CUNA represents nearly 5,000 federal and state credit unions, which collectively serve more than 135 million members nationwide. CUNA advocates for credit unions before Congress, state and federal agencies, and the courts.

Amici have a particular interest in the outcome of this case because of the negative impact it stands to have on the daily, critical work of every credit union in Virginia, not just 1st Advantage. Absent this Court's intervention, the district court's opinion will upend credit union practices and strap credit union members with burdensome—and in some cases unbearable—requirements far beyond what the law requires.

INTRODUCTION

Credit unions form a vital and unique part of this country's financial system. As not-for-profits designed to meet the needs of a particular field of membership, credit unions provide not only savings and lending services, but understanding. Their closeness to specific communities and professions allows them to offer tailored products and services, and deploy them with care, in a way that both builds financial security and wellness and avoids costly pitfalls.

Despite these benefits, credit unions face rising challenges in today's financial environment. Foremost among these challenges are two developments at the heart of this case—(1) a recent proliferation and explosion in the volume of automated clearinghouse ("ACH") payments and (2) an ever-expanding list of regulatory requirements. Adapting to these developments is particularly difficult for credit unions, which have limited resources and by law must build capital almost exclusively from their members. Nevertheless, credit unions of all sizes have met these challenges with creativity and determination, leveraging technology to achieve a manageable balance between automation and costly manual intervention.

The district court's opinion upsets that balance. By creating a legal negligence standard where there is none, and by ignoring the market pressures and industry norms that informed 1st Advantage's transaction processing measures, the

district court's decision destabilizes a system of clear rules and guidelines that credit unions follow to avoid liability. Left uncorrected, it will force credit unions to divert scarce employee resources to the arduous and inefficient task of manually reviewing hundreds of thousands of transactions every day. This additional burden is impossible for any credit union to implement. It will drain resources that could otherwise fuel better rates, lower fees, and enhanced products and services. And it will compromise credit unions' ability to steer a sound, customized financial course for communities across the Commonwealth and beyond.

Amici also strongly agree with (but do not repeat at length) the legal arguments advanced by 1st Advantage on appeal. Reflecting the practical realities of the modern automated payment system, Virginia's misdescription-of-beneficiary statute, Virginia Code § 8.4A-207, correctly imposes liability on financial institutions only when they have "actual knowledge" of a mismatch between the account number and the name of a receiving account. 1st Advantage lacked that knowledge here. The district court erred by holding 1st Advantage to a higher negligence standard.

For these reasons, the decision below should be reversed.

ARGUMENT

I. Credit unions form an essential part of our financial system but face increasing challenges in today's financial environment.

A. Credit unions play a vital and unique role in our financial system.

A credit union is a not-for-profit financial institution specifically organized to serve the interests of the particular field of membership set forth in the credit union's charter. 12 U.S.C. § 1752(1) (defining "Federal credit union"); *see also* Va. Code § 6.2-1300 (defining "credit union"). Credit unions "are member-owned" and "democratically operated," and "have the specified mission of meeting the credit and savings needs of consumers." *See* 12 U.S.C. § 1751, Statutory Notes (detailing congressional findings). These characteristics, among other distinct features, differentiate credit unions from other providers in the financial services industry.

Credit unions also offer important benefits. As a result of their unique structure, for example, credit unions are deeply embedded in the communities that they serve. This allows them to tailor financial products to particular demographics, and offer specialized services reflecting the unique needs of their constituents. *See, e.g.*, Credit Union National Association, *The State of Small Credit Unions Today* 11 (May 2021) ("CUNA Small Credit Union Report"), https://tinyurl.com/y6zk83xn. Indeed, credit unions support many institutional pillars in our society, including the military branches, church congregations, police

departments, and teacher organizations. Their knowledge of their members' particular needs "can mean the difference between the bills being paid on time and financial ruin." *Id.*

Additionally, in light of their non-profit status, credit unions are uniquely positioned to support low-income and vulnerable communities. One way credit unions have done this is by pioneering the issuance of affordable, small-dollar loans, sometimes referred to as "payday alternative loans." Alex Horowitz & Chase Hatchett, *Credit Union Small-Dollar Loan Volume Hit New High in 2022*, PEW (Mar. 31, 2023), https://tinyurl.com/e6abfaru. These loans offer hundreds of dollars in savings, compared with higher-cost options like payday loans. *Id.* Under the National Credit Union Administration's Short-Term Small Amount Loans Program, application fees for small-dollar loans like these at federal credit unions are now capped at $20, and interest rates at 28%. *Id.* "So borrowing $500 for three months under this program costs no more than $44, compared with an average of $450 to borrow that same amount via payday loans." *Id.* Credit unions offering these kinds of services provide households an option for avoiding financial hardship—missed bill payments, evictions, auto repossessions, utility disconnections—without drowning them in debt. *Id.*

Another valuable service provided by credit unions is the financial lifeline they extend to the immigrant population. *See* CUNA Small Credit Union Report at

5 (observing that credit unions are sometimes "the only lending option for undocumented immigrants"). Credit unions operating in these communities offer a first step toward bringing "unbanked" individuals into the financial mainstream, giving them a chance to build credit and avoid predatory alternatives. *See, e.g.*, Alexia Fernández Campbell, *This Credit Union in Disguise Is Helping Poor Latino Communities*, THE ATLANTIC (June 6, 2014), https://tinyurl.com/yh2tdmyx.

But the unique structure of credit unions also imposes limitations. For example, unlike other financial institutions, credit unions have access to subordinated debt in only very limited circumstances. In addition, due to their non-profit status, credit unions cannot raise money on capital markets. Instead, they must build capital almost exclusively from their members. *See, e.g.*, Nat'l Credit Union Admin., Overview of Federal Credit Unions (Apr. 14, 2022), https://tinyurl.com/4bxthh6m (observing that member shares "provide primary funding for the lending and investment activities" of the credit unions). This severely constrains the resource pool that credit unions have at their disposal, especially when adapting to emerging issues and absorbing unexpected regulatory burdens.

B. Credit unions face mounting challenges in today's financial environment.

Credit unions of all sizes confront an array of challenges today. The leading challenge for credit unions is navigating a host of federal regulations, which

expanded substantially in 2010 with the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Credit unions must also contend with the high costs associated with a massive—and increasing—volume of automated transactions. These industry-wide challenges hit credit unions particularly hard because of their limited ability to tap into new sources of capital in the face of new and emerging costs.

1. Credit unions must increasingly shoulder crushing regulatory burdens.

The compliance burden for credit unions is enormous and has only grown in recent years. Naming only the most prominent examples, credit unions are subject to the Dodd-Frank Act, the Bank Secrecy Act (and its associated Office of Foreign Assets Control requirements), the Electronic Funds Transfer Act, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Fair Debt Collection Practices Act, the Expedited Funds Availability Act, the Gramm-Leach-Bliley Act, reserve requirements, and the Truth in Lending Act. *See* Vincent Hui, Ryan Myers, & Kaleb Seymour, *2017 Regulatory Financial Impact Study Report of Findings*, CORNERSTONE ADVISORS 9 (Dec. 2017) ("2017 Cornerstone Study"), https://tinyurl.com/4e3z4fuv.

The compliance costs associated with the Dodd-Frank Act, in particular, represent the greatest new challenge that credit unions have faced over the last several years. A financial impact study commissioned by CUNA in 2014 found

that the Dodd-Frank Act added $1.7 billion in regulatory costs to the operating budgets of credit unions. Credit Union Nat'l Ass'n, *Regulatory Burden Financial Impact Study* 2 (2014), https://tinyurl.com/53rkxraa. When combined with the estimated $1.1 billion in reduced revenues that the new regulations occasioned, the study projected a $2.8 billion drain on the industry. *Id.* The findings of a follow-up study in 2017 suggest that the impacts are here to stay. 2017 Cornerstone Study at 5 ("[R]egulatory costs may have settled into a new, elevated normal generated by new regulations put in place since 2010."). As of September 2021, in Virginia alone, CUNA estimated that credit unions carried a total regulatory burden of approximately $977 million in the preceding year. Credit Union Nat'l Ass'n, Estimated Regulatory Burden by State (Sept. 2021), https://tinyurl.com/322yfy29. And NAFCU's 2021 Report on Credit Unions confirmed that credit unions devote a significant amount of resources to meeting unrealistic regulatory compliance expectations: respondents indicated that 24% of staff time is currently devoted to regulatory compliance, and for small credit unions under $250 million in assets, that figure grows to 28%. Nat'l Ass'n of Federally-Insured Credit Unions, *Report on Credit Unions* 16 (2021), https://tinyurl.com/29uneucw.

While intense regulation influences all credit union operations, it has a particularly direct effect on employee-related expenses. 2017 Cornerstone Study at 5. Complying with regulations requires significant employee time and expertise,

which translates to higher employee costs. *Id.* Roughly one in five credit union employees spends all of his or her time on regulatory compliance. *Id.* To satisfy the requirements of the Bank Security Act ("BSA"), for example, credit unions must devote employee and training resources to monitoring and ferreting out suspicious activity. Because identifying suspicious activity involves fact-specific decisionmaking, credit unions have no choice but to sink considerable time and energy into this compliance effort. According to a survey conducted in 2017, BSA and anti-money-laundering activities constituted the third-biggest regulatory drain on credit union resources, representing roughly $530 million annually. 2017 Cornerstone Study at 9.

It is also clear that reducing the regulatory burden on credit unions would benefit members. In 2017, when credit union CEOs were surveyed on where they would reallocate funds earmarked for regulation, the vast majority of the responses focused on items that would increase member benefits. *Id.* at 6. These included offering better rates, lower fees, and investing in enhanced products and services. *Id.* at 6–7.

2. Another important challenge facing credit unions is the rising volume of automated clearinghouse transactions.

Credit unions—like financial institutions more broadly—handle a tremendous volume of ACH transactions every day. The ACH system "is a nationwide network through which depository institutions send each other batches

of electronic credit and debit transfers." Board of Governors of the Federal Reserve System, Automated Clearinghouse Services (Sept. 28, 2020), https://tinyurl.com/49rpknd4. Common examples of ACH *credit transfers* include direct deposits of payroll and social security benefits; common examples of ACH *debit transfers* include direct debiting of mortgage payments and utility bills. *Id.* In addition to these kinds of recurring payments, financial institutions also increasingly use the ACH system to process one-time debit transfers such as internet payments. *Id.*

The size of the ACH system is staggering. There were over 30 billion ACH payments in 2022, totaling over $72 trillion. Nat'l Automated Clearinghouse Ass'n ("Nacha"), Overall ACH Network Volume (2023), https://tinyurl.com/5fvpnbkp. Among originating institutions, the largest institutions handled ACH volume of more than 26.2 billion payments, an increase of 4.7% over 2021. Nacha, Nacha Releases Top 50 Financial Institution ACH Originators and Receivers for 2022 (Mar. 8, 2023), https://tinyurl.com/2thcrk3p. The fifty largest receiving institutions had ACH payment volume of 18.8 billion, up 3.4% from 2021. *Id.* When accounting for "off-Network payments" initiated and received by the same institution, total ACH payment volume for 2022 was 35.3 billion, an increase of 4.4% from 2021. *Id.*

These numbers reflect an extreme growth in ACH payments in just the past few years. For example, last year's Federal Reserve Payment Study concluded that "the value of core noncash payments in the United States grew faster from 2018 to 2021 than in any previous FRPS measurement period since 2000." Board of Governors of the Federal Reserve System, Federal Reserve Payment Study (July 27, 2023), https://tinyurl.com/3za8heeu. ACH transfers drove this precipitous increase, accounting for more than 90% of the rise in non-cash payments. *Id.* "Since surpassing checks as the highest-value noncash payment method in 2009 . . . , ACH transfers have grown to $91.85 trillion, 72 percent of core noncash payments value in 2021." *Id.*

In light of these ACH trends, it comes as no surprise that ACH processing ranks as the single biggest regulatory burden weighing on credit unions. 2017 Cornerstone Study at 9. It accounts for roughly $589 million in credit union costs annually. *Id.*

II. Credit unions like 1st Advantage must rely on automated technology and clear rules to meet the challenges of the modern financial industry without squandering precious human resources.

In light of ballooning regulatory costs and the explosion of ACH transfers, credit unions must rely on automated technological processes to remain viable.[2] Otherwise, regulatory and ACH-related burdens would devour credit union resources and sap credit unions' ability to perform core functions. At the same time, credit unions strive to strike a manageable balance between automation and intervention, and already devote substantial human resources to the often context-dependent task of BSA compliance. Against this backdrop, the steps that 1st Advantage took to address the threats presented in this case not only complied with the law, but were eminently reasonable. *See* Opening Br. of Appellant, ECF No. 19 at 17–21.

A. Credit unions must rely on monitoring software and clear rules to strike an appropriate balance between automation and intervention.

Credit unions have no choice but to rely on automated processes to complete the hundreds of millions of transactions that they process every year. Credit union software filters through a staggering volume of transactions and triggers an alert when a transaction prompts further review. Because the vast majority of

[2] For some credit unions, especially small and mid-sized credit unions, simply implementing technological processes poses a challenge. CUNA Small Credit Union Report at 14.

transactions are not suspicious, effective software allows credit unions to prioritize true threats while avoiding the waste associated with needlessly investigating and processing false positives. Calibrating an appropriate balance is essential. Too few alerts, and credit unions risk missing suspicious activity. Too many alerts, and credit unions risk paralysis and excessive resource drain.

In striking a proper balance, credit unions must rely on clear but flexible rules. They often turn to industry standards to do so. In the context of ACH transaction monitoring, for example, many credit unions depend on the rules promulgated by Nacha to set up and manage their ACH monitoring systems. Abiding by industry standards gives credit unions clear guidelines to follow and provides comfort that individual practices conform to industry norms.

Importantly here, Nacha rules and industry norms do not compel name verification for ACH transactions. In other words, when the name given for the recipient of an ACH entry does not match the name on the receiving account, Nacha rules dictate that institutions need not reject the transactions. Specifically, Nacha Rule 3.1.2 states that a receiving institution "may rely solely on the account number contained in an Entry for the purpose of posting the Entry to a Receiver's account, regardless of whether the name of the Receiver in the Entry matches the name associated with the account number in the Entry." JA483 [Rule 3.1.2]. This Nacha rule is seconded by the Green Book—a comprehensive guide for financial

institutions that process ACH transactions with the federal government—which notes that "a financial institution is not required to manually verify that the name on the ACH entry matches the name on the account at the time the payment is posted." U.S. Dep't of Treasury, Green Book, Ch. 2 at 2-5–2-6, https://tinyurl.com/mtppnne9.

This guidance makes sense. As the official comments to Section 8.4A-207 of the Virginia Code explain, "the inclusion of the name of the beneficiary . . . can be useful," but "*plays no part in the process of payment*." Va. Code § 8.4A-207, cmt. 2 (emphasis added). In other words, as with paper checks, the named beneficiary provides an additional data point for financial institutions but does not bear on the core payment-processing function. As a result, the comments warn against the prioritization of name-matching over automation: "if a duty to [determine whether named beneficiary matches the account owner] is imposed on the beneficiary's bank *the benefits of automated payment are lost*." *Id.* (emphasis added). These benefits include "substantial economies of operation and the possibility of [reducing] clerical error." *Id.*

In addition to clarity, credit unions also benefit from flexibility in the implementation of the rules governing technological practices. This is especially true when it comes to discharging statutory BSA and anti-money-laundering obligations. Most credit unions deploy transaction monitoring software, like

Financial Crimes Risk Management ("FCRM") software, to help them detect suspicious activity. *See* Devon Lyon, *NAFCU's 2017 Report on the State of BSA Risks and Compliance Issues* 4 (2017), https://tinyurl.com/yh48e43z (discussing survey responses indicating that 94.44% of credit unions use automated transaction monitoring software for BSA compliance). Like the software that monitors ACH transactions, FCRM software performs an important initial screening function that allows institutions to segregate normal activities from suspicious ones, and focus on the most concerning threats. But once an alert is triggered, costly manual review is required. Credit unions that can afford to do so therefore employ staff members dedicated exclusively to BSA compliance who are charged with making fact-based judgments about the alerts and warnings that they receive.

B. 1st Advantage's software systems and practices complied with both the financial system's ground rules and the law, and struck an appropriate balance between automation and intervention.

The 1st Advantage ACH processing practices that lie at the core of this case fall well within the clear guidelines set by industry standards. They also comply with the law.

As the district court's opinion discusses, 1st Advantage maintained a "Datasafe" system that generated and saved reports in an electronic database for each and every one of the many thousands of ACH transactions posted every day. JA560–561 [*Studco Bldg. Sys. US, LLC v. 1st Advantage Fed. Credit Union*, No.

2:20-CV-417, 2023 WL 1926747, at *5–6 (E.D. Va. Jan. 12, 2023)]. The system generated "exceptions" if the software identified a problem meriting manual review. *Id.* It also generated "warnings" for certain lower-risk types of transactions, including those in which the beneficiary of the transaction did not match the name on the receiving account. *Id.* Consistent with the recent explosion of ACH payment volume discussed above, 1st Advantage's senior ACH processor testified that the Datasafe system generated "*hundreds to thousands*" of warnings related to mismatched names every single day. *Id.* (emphasis added). And as the district court recognized, "[t]he majority of warnings generated on a daily basis are not useful to 1st Advantage." *Id.*

None of the four incoming ACH payments from Studco triggered an "exception," and thus they were posted to the 1st Advantage account without manual review and intervention. *Id.* While the transactions did generate "warnings," for which 1st Advantage did not perform a manual review, this was fully consistent with Nacha Rule 3.1.2 and the Green Book. Indeed, it would not have been commercially reasonable—or possible, frankly—for 1st Advantage to engage in the kind of intense manual review of mismatched beneficiary payments that could have uncovered the fraudulent activity. Each of the four warnings triggered by the Studco payments was disguised among "hundreds to thousands" of similar warnings. Thus, while it is tempting to focus on these four warnings, in a

world where 1st Advantage must sort through all of the warnings it receives, "the benefits of automated payment are lost." Va. Code § 8.4A-207, cmt. 2.

1st Advantage's anti-money-laundering and BSA practices also fell well within industry standards. Like almost every other credit union in the country, 1st Advantage relied on FCRM software to alert it to suspicious activity on its system. JA559 [*Studco Bldg. Sys.*, 2023 WL 1926747, at *5]. After an alert was triggered, "1st Advantage's analysts would investigate the alerts to determine appropriate next steps." *Id.* After receiving an alert, 1st Advantage's BSA staff would "review past account activity, general account activity, and the accountholder's relationship with the institution." *Id.*

In this case, however, the FCRM software "did not trigger an alert" and no investigation was initiated. JA567 [*Studco Bldg. Sys.*, 2023 WL 1926747, at *8]. It would not have been reasonable for 1st Advantage to second-guess the software's alert system in a way that could have uncovered what turned out to be foul play.

1st Advantage's transaction processing practices also complied with the law. In line with industry-wide best practices, Virginia law holds financial institutions liable for a misdescription-of-beneficiary claim only when they have "actual knowledge" of a discrepancy between the named and actual beneficiary of a transfer. Va. Code § 8.4A-207. Here, because 1st Advantage never discovered the

mismatched names for the transactions, it never had knowledge of the misdescription. By imposing a negligence standard over and above the actual knowledge standard, the district court's opinion upends the settled law of transaction processing, and, if allowed to stand, will send shockwaves through the financial industry. *See* Opening Br. of Appellant, ECF No. 19 at 13–21.

III. The district court's opinion muddies the waters for credit unions facing the demands of today's financial environment and, left uncorrected, would overburden credit unions across the Commonwealth already struggling under the weight of crushing regulations.

A. The district court's opinion ignores that 1st Advantage's practices for processing ACH payments and investigating fraud meet industry standards.

One especially damaging aspect of the district court's opinion is that it completely fails to situate 1st Advantage's practices in the context of prevailing industry standards. In particular, the opinion overlooks that 1st Advantage's ACH practices were fully compliant with guidelines promulgated by ACH administrators like Nacha and the federal government. In doing so, the opinion calls into question whether complying with industry guidance is enough to avoid liability, destroying the predictability that sources like the Nacha Rules and the Green Book provide, which could lead to significant uncertainty in the processing of millions of ACH transactions at credit unions in the Commonwealth. In the shadow of the district court's opinion, credit unions across the Commonwealth will need to reevaluate their ACH practices and, in many cases, implement processes that go above and

beyond the long-settled measures that have been considered best practices for years. That reevaluation and implementation process will not come cheap.

The opinion also throws prevailing anti-money-laundering and BSA compliance practices into doubt. 1st Advantage integrated FCRM software into its monitoring practices in a manner that is typical for credit unions across the country. Indeed, it avoided tinkering too much with the program by maintaining standard settings. JA559 [*Studco Bldg. Sys.*, 2023 WL 1926747, at *5]. It remains far from clear that altering the programming of the FCRM software would have made any difference in uncovering the problematic conduct in this case. The district court's opinion will force credit unions to plow additional money into watching the FCRM watchman, and could even incentivize "customized" settings that give the illusion of security but actually create new blind spots for fraud-prevention efforts.

B. The district court's opinion will force credit unions to allocate more resources to transaction review to avoid liability for third-party activity.

The district court's opinion holds that 1st Advantage's failure to employ a mechanism to distinguish high-risk from low-risk ACH "warnings," and to elevate high-risk transactions for further review, was commercially unreasonable. JA580 [*Studco Bldg. Sys.*, 2023 WL 1926747, at *14]. But it is unclear whether 1st Advantage's software system allows for such discrimination among warnings.

Moreover, it is not clear what an appropriate risk threshold would be to trigger further review. Without clear guidance on these questions, credit unions will have no choice but to overcorrect and devote scarce resources to reviewing a large share of the "hundreds to thousands" of ACH transactions that trigger warnings each and every day. JA560 [*Studco Bldg. Sys.*, 2023 WL 1926747, at *5]. In doing so, they will lose out on the "substantial economies of operation" that automation provides. Va. Code § 8.4A-207, cmt. 2. In light of these effects, which will be added to the already-substantial manual burden of BSA compliance, the district court's opinion will bring ACH processing at credit unions across the Commonwealth to a grinding halt.

The same goes for FCRM software. In the wake of the district court's opinion, credit unions will have to rethink their reliance on FCRM alert-generation, and inevitably sink even more resources into monitoring software systems and undertaking manual review.

C. These compliance costs will strain credit union resources and pose an existential crisis for many within the industry.

The challenges facing credit unions in today's financial system are significant. Credit unions expend valuable resources complying with an ever-expanding list of regulatory requirements, simply as the cost of doing business. At the same time, evolving practices, like the exponential growth of ACH transactions over the past decade, present new challenges for community-based organizations

that cannot always scale up to meet rising demand out of existing resources. Credit unions across the Commonwealth have demonstrated remarkable flexibility and resolve in rising to these challenges in the past few years, finding ways to support the needs of their members without compromising core savings and lending practices. But under the new standard set by the district court's opinion, those efforts likely will fall short as credit unions face no choice but to devote still more time and resources to regulatory compliance. Some will not survive.

The high price of these extreme compliance measures would be borne not just by credit union members, who will lose out on the better rates, lower fees, and enhanced products and services that credit unions could otherwise provide. It also will harm local and regional sub-communities—they will lose trusted financial partners that understand their specific needs as fewer and fewer credit unions are able to bear the costs of regulation. It will harm low-income and at-risk communities—they will lose out on the innovative and creative solutions bringing financial wellbeing to their members. And it will harm the broader financial services industry—it will lose an important source of diversification as regulatory constraints demand ever more consolidation and scale.

CONCLUSION

The district court's opinion turns a blind eye to the market pressures and industry norms that support the transaction-processing measures criticized in this case. As a result of this myopic approach, the decision threatens to destabilize the system of settled rules that credit unions follow when implementing transaction software, and will assign credit unions an impossible task—the manual review of thousands of transactions every day. The Court should reverse.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I certify that this brief complies with the requirements of Federal Rule of Appellate Procedure 32(a)(5) and (a)(6) because it has been prepared in 14-point Times New Roman, a proportionally spaced font, and that it complies with the type-volume limitations of Rules 29(a)(5) and 32(a)(7)(B), because it contains 4,711 words, excluding the parts exempted by Rule 32(f), according to the count of Microsoft Word.

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CERTIFICATE OF SERVICE

I hereby certify that on October 17, 2023, I electronically filed this brief with the Clerk of this Court by using the appellate CM/ECF system. The participants in the case are registered CM/ECF users and service will be accomplished by the appellate CM/ECF system.

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