

**COMMENTS OF THE NATIONAL RETAIL FEDERATION IN RESPONSE TO
FEDERAL RESERVE'S PROPOSED CHANGES TO REGULATION E**

Board of Governors of the Federal Reserve System

Regulation E; Docket No. R-1210

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Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Regulation E; Docket No. R-1210

Dear Ms. Johnson:

These comments are submitted by the National Retail Federation in response to the Federal Reserve Board's proposal to amend its Regulation E and revise its accompanying official staff commentary. We are submitting these comments because the retail industry will be keenly affected by several of the Board's proposed changes.

The National Retail Federation is world's largest retail trade association, with membership that comprises all retail formats and channels of distribution including department, specialty, discount, catalog, Internet and independent stores as well as the industry's key trading partners of retail goods and services. NRF represents an industry with more than 1.4 million US retail establishments, more than 23 million employees – about one in five American workers – and 2003 sales of \$3.8 trillion. As the retail industry umbrella group, NRF also represents more than 100 state, national and international retail associations.

We should note that the retail industry is extremely competitive. The net margin in most retail establishments has historically been very narrow (on the order of 2%). In recent years relentless price pressure from large discounters has caused those margins to tighten even further. The demand to deliver value to consumers in a highly competitive environment has made retailers exquisitely sensitive to the cost-benefit equation.

As to the issues addressed in the Board's proposal, many of our members currently convert paper checks to electronic debit entries, either when they are received as payment at a lockbox or, increasingly, at the point of sale. Some of our members inform consumers that fees for returned checks will be automatically debited to their accounts. A few of our members participate in payroll card plans for their employees. And some of our members who make use of the Internet and telephone channels for

sales are affected by Regulation E's interpretations regarding recurring transactions. Accordingly, these are the topics we will address in our comments.

I. Electronic Check Conversion

A. Coverage of Regulation E

Although we can appreciate the desirability of more uniform, conspicuous and understandable consumer notices in connection with check conversions, we do not believe it is appropriate to subject merchants and other payees who are not financial institutions to Regulation E for this purpose. Section 904 of the Electronic Fund Transfers Act gives the Federal Reserve the authority to make Regulation E apply to persons other than financial institutions holding a consumer's account only if such persons make EFT services available to consumers. A payee who informs a consumer that his check will be converted to an electronic debit entry is not providing the consumer with an EFT service. It is simply obtaining an authorization to electronically withdraw funds from the consumer's account.

If the Federal Reserve prescribes the type of notice that is required for a consumer's financial institution to deem a check conversion transaction authorized, the Rules of the National Automated Clearing House Association will ensure that this type of notice is used. An Originating Depository Financial Institution under the NACHA Rules must warrant that each transaction it originates for a payee is properly authorized, and payees (Originators under the NACHA Rules) generally warrant to their ODFIs that they have obtained proper authorizations. Thus, the effect will be the same, but payees of converted checks should not be misled into thinking they will be brought under the EFT Act or Regulation E on the incorrect theory that they are providing an EFT service to consumers.

B. Particulars of the Notices

1. At the Point of Sale. You have solicited comment on whether merchants and other payees should be required to obtain the consumer's written, signed authorization to convert checks at POS. We believe you should require financial depository institutions to provide merchants with the option of using a sign or having the consumer execute a form that authorizes conversion at the point of sale. Two points are key. First, POS notices are useless unless they are brief and to-the-point. Second, there is an increasing amount of required signage clutter at the checkout counter that only serves to confuse. Rather than the long statement proposed in Model Clause A-6 (b), we recommend a brief, understandable statement such as "Checks may be converted to electronic fund transfers." Whether there is a notice or the consumer signs a form is far less indicative of informed consent than if the message is short and clear before the check is accepted. We also believe that the authorization notice for an NSF fee at POS should be short, such as: "We may debit your account \$__ if you have insufficient funds."

2. ARC Transactions. We believe that the authorization statement you propose in Model Clause A-6 (a) to include with billing statements, although far longer than we suggest for POS notice, is generally appropriate because there is more time for a consumer to review a billing statement. However, we do not think it is appropriate to indicate that funds may be withdrawn from the consumer's account more quickly. Check writers are supposed to have sufficient funds in their accounts when they write checks. The proposed statement could encourage consumers whose checks are not converted to abuse the checking system.

3. Option to Process Check or Convert to EFT. We agree that payees should be able to have the option to process the checks they receive or convert them. A payee should inform consumers that the payee will have this option. We strongly oppose specifying circumstances in which the option may be exercised. The precise reasons why a national department store chain might choose to convert some types of checks and not others can be quite technical and will be of little interest to consumers. For example, checks in payment for certain services might be converted, whereas checks in payment of merchandise might not. In a large operation there could be a dozen permutations. Enumerating them would actually make authorizations more difficult to understand. We also do not think consumers will decide whether to send a check based on an evaluation of their rights under the checking system versus Regulation E. The consumer who intended to send a check would have had fewer rights but he/she still intended to send a check. We believe the only relevant information for the consumer in this situation is notice that the consumer's check may not be returned.

II. Payroll Card Accounts

A. Coverage of Regulation E. We believe that employees who use payroll cards for routine receipt of wages on a continuing basis should be entitled to the applicable protections of the EFT Act and Regulation E. We believe this regardless of whether the card product is operated or managed by the employer, a third-party payroll processor or a financial depository institution. We also believe the law's protection should not be influenced by whether the underlying funds are held in a depository institution in the employer's name only, in a pooled reserve account at the bank with individual sub-accounts, or elsewhere. None of this affects the need for the consumer's accumulating payroll funds to be protected. We agree with the Board that including payroll accounts in the definition of "account" for Regulation E should not imply that this is an account for the purpose of any other law or regulation, and it would be good if the Regulation E comments said so explicitly. We also agree that special payment or bonus cards should not be covered.

B. Who is Responsible. As the Board notes, there are many arrangements for the issuance of payroll cards. Most commonly an employer establishes the program in conjunction with a bank or third party service provider, who promotes and runs such programs for many companies. In such cases we believe that the Regulation E

responsibilities should fall on the program provider, not the employer. A bright line for determining if the provider should have the Regulation E responsibilities is where and how the underlying funds are maintained. If the provider maintains the funds and/or the sub-accounts, Regulation E should assume that the provider, not the employer, is the responsible party, and the payroll-account-related Regulation E responsibilities and liabilities should devolve upon the provider. Only in the case where an employer maintains and manages the individual accounts or sub-accounts of the employees can it be said that the employer “directly or indirectly holds the consumer’s account” and should be subject to Regulation E.

The Board has suggested that the bank, the third party service provider and the employer may all be deemed the “financial institution” and be subject to Regulation E, and that they should work out among themselves who will provide the regulatory obligations. We think this would put most employers, who are passive participants in the payroll card process, in a difficult position vis-à-vis the true providers. The intricacies of Regulation E (or indeed even its existence) are far outside the purview of many of the kinds of employers who would consider payroll card programs, most of whom would not think of themselves as financial institutions. Employers would be in a buyer beware situation, and would need to carefully negotiate, or renegotiate, their agreements with providers to cover these issues and provide for indemnities. Except in the last case mentioned in the paragraph above, most employers ultimately will be forced to rely upon the expertise of true financial institutions to navigate the Board’s requirements – that is where the obligation should reside. To do otherwise necessarily would delay the timeframe for the effective date of the Regulation E sections applying to payroll cards to give the parties time to sort these matters out among themselves and only then to provide for compliance.

C. EFT as Only Form of Payment. It is not clear to us what the Board intends by the following statement on the top of page 9 of its proposal materials: “For purposes of the access device issuance rule in § 205.5, a payroll card would be considered a solicited access device so long as a consumer must elect to have his or her salary credited to a payroll card account.” Does this imply that an employer may require its employees to accept payment to a particular payroll card program despite § 913 of the EFT Act, which prohibits a person from requiring a consumer to establish an account for the receipt of electronic fund transfers with a particular financial institution as a condition of employment? Whether or not that is intended, we believe that the Act would permit an employer to require an employee to choose either direct deposit of payroll to a financial institution of the employee’s choosing or deposit to the employer’s chosen payroll card program. We would appreciate your addressing this issue in the commentary.

III. Recurring Debits

A. Written Authorizations. We are pleased that the Board has proposed removing its prohibition on using recordings of telephone conversations as a way to

obtain a consumer's authorization for a recurring sale made with a debit card. We believe this is a helpful recognition of the enormous number of consumers who routinely use debit cards today for all types of retail purchases. We would prefer a definitive statement from the Board that recordings that capture the appropriate information constitute a writing that has been "similarly authenticated." We do not see how the Board would have to interpret the E-Sign Act to make that interpretation of the EFT Act and Regulation E.

We also believe that it would be desirable for consumers who wish to use their debit cards for recurring telephone sales to be able to give the telephone merchant an oral authorization which the merchant would follow with a prompt written confirmation giving the consumer the opportunity to readily cancel the sale if consumer wanted to do so. We note that the Telemarketing Sales Rule of the Federal Trade Commission does not require recordings to verify any debit card sales when the card used has legal protections against unauthorized use and a method to resolve disputes. In short, we think that the use of debit cards for all types of transactions has become so common that it is a burden on electronic commerce and a disservice to consumers to require them to do more to authorize a recurring debit card sale than a recurring credit card sale.

B. Bona Fide Errors. We support the Board's commentary revisions which indicate that a merchant who asked for a credit card for a recurring sale but got a debit card by mistake is protected by the bona fide error provision, and does not have to check his recurring sales against BIN tables to determine whether some of those transactions were debit card sales. As the Board points out, merchants had no way to know which cards were debit and which were credit until settlement of the merchant class action in the case of Wal-Mart against Visa and MasterCard forced the bankcard associations to differentiate the cards' appearances (which they must complete by January 2007) and forced them to make BIN tables available to merchants on request. Even though BIN tables are now available, MasterCard has added new digits to card numbers that continue to make it difficult for a merchant to determine whether a card is debit or credit even with BIN tables. To the extent that consumers are confused as to whether a card is debit or credit, that is largely because banks have encouraged consumers to say "credit" when they present their debit cards at the supermarket, so that the banks can receive the higher signature debit interchange fees.

We agree with the Board that what is a reasonable procedure for avoiding taking debit cards will vary with the circumstances. Although asking whether a card a consumer offers on a phone call is a debit card or a credit card is one way to try to avoid taking debit cards, we are not sure it is the best way, and we would prefer if it were not listed in the commentary as the example that provides safe harbor protection. We believe that a merchant should receive safe harbor protection in Comment 10(b)-7 as long as the merchant confirms with the consumer that the card offered by the consumer is a credit card.

The National Retail Federation appreciates this opportunity to share our views with the Board regarding its proposed changes to Regulation E and its Official Staff Interpretations. We have essentially provided you only an outline of our views on the topics addressed. We would be happy to sit down with you to discuss any of these matters at greater length, and we encourage you not to hesitate to call upon us.

Respectfully submitted

A handwritten signature in black ink, appearing to read "Mallory B. Duncan". The signature is stylized, with a large, sweeping initial "M" and a distinct "D" at the end.

Mallory B. Duncan
Senior Vice President
General Counsel