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November 19, 2004

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

**Re: Docket No. R-1210**

Dear Ms. Johnson:

Thank you for the opportunity to provide comments on a proposal to amend Regulation E with regard to electronic check conversion (ECK) services.

The Food Marketing Institute (FMI) conducts programs in research, education, industry relations and public affairs on behalf of its 2,300 member companies — food retailers and wholesalers — in the United States and around the world. FMI's U.S. members operate approximately 26,000 retail food stores with a combined annual sales volume of \$340 billion — three-quarters of all food retail store sales in the United States. FMI's retail membership is composed of large multi-store chains, regional firms and independent supermarkets. Its international membership includes 200 companies from 60 countries.

FMI's members continue to be very interested in electronic payments advances, particularly those that may have the ability to lower costs, speed transactions, and improve customer shopping experiences. ECK is one of the new electronic transaction systems that supermarket retailers have been interested in piloting and adopting. Because of this interest FMI and several of our member companies serve as members of NACHA's Electronic Check Council (ECC) and have followed developments relating to this payment type very closely. Although some of our members have had very positive ECK pilots, serious obstacles remain before wide-scale adoption by supermarket retailers in a high-volume multi-lane retail environment can be achieved. Some of those barriers include: administrative returns of checks (wrong routing information); identifying business checks ineligible for conversion; the NACHA requirement to obtain a signature authorization; and the expense of check imaging equipment.

ECK is a promising payment type and has the potential for significant growth, to the benefit of merchants and consumers. But that potential may not be realized if additional unnecessary and burdensome requirements are placed on its use. We are

concerned that aspects of the subject proposal to amend Reg. E with regard to electronic check conversion are unnecessary and burdensome and could slow its adoption.

The proposed amendments would for the first time place merchants under Reg. E. Among other things, merchants making ECK services available to consumers would be required to obtain a customer's authorization to initiate a one time electronic fund transfer from the customer's account each time each time a check, draft or similar paper instrument is used as a source document. In addition, the proposed regulation would require the merchant to notify the customer that the funds may be debited more quickly and that the check will not be returned by the financial institution holding the customer's account. We believe the authorization requirement needs to be clarified and that the notice requirement, as drafted, is unnecessary, burdensome and inconsistent with the treatment of other payment types.

### **Authorization**

As you acknowledge in the Notice of Proposed Rulemaking, the National Automated Clearing House Association (NACHA) rules currently govern ECK transactions. The NACHA rules require that customers be given notice and they also require retailers to obtain a signature authorization from a customer each time a check, draft or similar paper instrument is used as a source document. FMI is among a group of NACHA members that believe the requirement for signature authorization in the NACHA rules is unnecessary.

The proposed amended regulation specifies only that authorization must be obtained. Sec. 205.3(b)(2). However, the official staff commentary to the regulations states that authorization is obtained "...where the consumer receives notice that the transaction will be processed as an EFT and goes forward with the transaction." We strongly support the Federal Reserve's conclusion that notice, combined with a completed transaction, equals authorization and that a signature authorization will not be required to comply with Reg. E. This interpretation promotes consistency with consumer notices for other types of EFTs. There is no useful purpose to be served by an additional signature authorization requirement. Such a requirement would impose significant costs on merchants for signature capture and storage, as well as the resulting increase in tender time (meaning longer checkout lines) that would result from asking consumers to undertake the process of reading and understanding a disclosure and signing an authorization at checkout. Such a requirement would be excessive and would cause unnecessary delays at checkout, benefiting neither the shopper nor the merchant.

Moreover, signature request would discourage the use of check-initiated ECK because customers using other payment forms would not face the same requirement. A customer using another access device, such as a loyalty card or key fob to initiate an ACH transaction instead of a paper check (many supermarket retailers have such programs) would not have to sign an authorization for each transaction. Likewise, if the customer utilized one of the self-service lanes in that same supermarket, signed authorization to convert that paper check to an ACH transaction would not be required in

lane. Finally, if the customer used a credit card to pay for their groceries and then mailed a check to pay their credit card bill, signed authorization is not required to convert the check for each bill.

### **Notice**

Customer service is tremendously important to all shoppers, especially supermarket shoppers. Surveys consistently show that a key element of supermarket shopper satisfaction is a quick and easy checkout. FMI members are constantly seeking to expedite the checkout process. At the same time, they understand that shoppers don't like surprises at the check stand. They certainly would never want a customer to feel misinformed about a payment transaction and how it will be processed.

Therefore, FMI's members support the provision of notice to consumers concerning ECK. However, the form and nature of that notice should reflect the reality of the shopping experience. The typical customer is in the supermarket or grocery store more than twice a week and often uses the same payment type for each visit. A standard notice message to customers with a short, easy to understand message that gets their attention is most effective. Supermarket retailers can supplement that notice with additional information at the customer service desk if necessary.

The proposed amended regulations do not specify the type of notice required. However, the staff commentary states that "(E)xamples of notice include, but are not limited to, signage at POS and individual written statements provided to consumers." While we believe signs and individual written statements are adequate notice, other equally appropriate forms of notice could include brochures, bag stuffers, receipt tapes, newsletters, and video and audio presentations, among other things. In sum, grocery retailers are creative and imaginative when it comes to informing consumers, and the regulation itself should acknowledge the myriad ways that notice may be provided.

FMI is also concerned about the message to be included in the required notices. In particular, the regulation requires that merchants notify the customer that funds may be debited more quickly from their account and that their check will not be returned by the financial institution holding the customer's account. We disagree with the need for a message stating that funds may be deleted more quickly using ECK. Most of the checks customers write at a supermarket are local checks that already clear very quickly. With the advent on October 28, 2004 of legal protections under Check 21, many additional paper checks will also clear electronically and also very quickly. Thus, the required notice would seem to serve no useful purpose as it is unlikely that ECK transactions would be debited more quickly than a Check 21 electronically-processed check.

Additionally, checks imaged and destroyed with the legal protections provided under Check 21 will not be returned to customers by their financial institution. Thus, regardless of whether a customer's transaction is processed via ECK or Check 21 or via the paper check, the customer is not likely to get their original paper check back. In fact, the scenario in which a customer is most likely to get their paper check back is actually

this situation where the voided ECK is returned to the customer immediately at the point-of-sale (POS). Therefore, a notice to customers that the check will not be returned by the financial institution holding the customer's account could be incredibly confusing and possibly inaccurate. We are pleased that the proposed staff commentary acknowledges this and states that when checks are returned at the POS the notice need not state that checks won't be returned by the financial institution. However, the regulation itself does not include this exception. Sec. 205.3(b)(2)(iii) must be modified to reflect this exception.

Finally, the POS checkout "real estate" is very limited. A sign of the length suggested in the model clauses (87 words) would be very difficult to place at checkout in a high volume, multi-lane retail store in any clear and conspicuous size. And, as discussed above, a more concise notice limited to authorizing an ECK transaction would be more helpful to consumers. We do agree with the proposed notice provisions that would allow retailers to have the flexibility to process the payment either as a check or a one-time electronic transaction. This would be particularly important for returned items, either insufficient funds or an administrative return and those checks, like business checks, that do not qualify for ECK.

### **Paperwork Burden**

The proposed rule will bring a new universe of business entities under the purview of Reg. E and the Federal Reserve. There are over 200,000 grocery retailers serving U.S. consumers and there are hundreds of thousands of other merchants and retailers of other types as well. Many, if not most, of these merchants accept checks for payment and potentially could be using ECK systems and, therefore, could become subject to these regulations. The agency's analysis of the impact of the proposed rule required by the Paperwork Reduction Act of 1995 vastly underestimates the potential impact of this rule, which will bring so many non-financial institutions under the Federal Reserve's regulation for the first time.

Accepting for this purpose only the premise that the Federal Reserve has the statutory authority to regulate non-financial institutions in this manner, and that the burden analysis is accurate, the results are startling.<sup>1</sup> The analysis concludes that the total burden for the one time ECK disclosure for non-financial institutions engaging in ECK transactions is **95,200** hours compared to just **80** hours for financial institutions.<sup>2</sup>

Additionally, the agency concludes that the proposed rule would increase the total burden for currently regulated entities by **11,547** hours and for all other entities potentially covered by the rule by approximately **255,788** hours.

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<sup>1</sup> As noted in the Notice of Proposed Rulemaking the Elective Funds Transfer Act "expressly provides that transactions originated by check, draft or similar paper instrument are not governed by the Act."

<sup>2</sup> These numbers are based on 8 hours per entity (a grossly unrealistic number) just impacting **10** financial institutions and **1,239** non-financial institutions. Obviously these numbers will grow considerably if ECK is accepted as a workable system.

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Taking these numbers at face value (we believe they are a significant under estimate), this is a major new regulatory burden (and cost) for entities not previously regulated by the Federal Reserve and with which the Federal Reserve has no on-going relationships or oversight function. Given some of the potential problems with the regulation we raise above, along with the dubious consumer benefit of certain aspects of the proposal, we believe a more careful cost/benefit of analysis of the proposed rule should be undertaken.

In addition, we believe that if these rules go into effect, it is essential that the Federal Reserve develop an internal structure to work with non-financial institutions on this, and other issues affecting those institutions. We urge the Federal Reserve to strongly consider the creation of an advisory council or, at a minimum, staff liaison for these non-financial institutions. We believe this would be an important and useful step.

FMI appreciates the opportunity to offer comments on this important topic and looks forward to working with the Federal Reserve on this and other payment issues.

Sincerely,

George Green  
Vice President  
General Counsel