Comments on Financial Regulatory Relief

by the

National Retail Federation

National Council of Chain Restaurants

and

Shop.org

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COMMENTS ON FINANCIAL REGULATORY RELIEF

Conflict Minerals Reporting

While the retail industry supports efforts to achieve the objectives of §1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Conflict Minerals Law), we remain concerned that the law has not had the intended effect and has resulted in substantial burdens for all who need to comply with its requirements. We believe it is time to reevaluate the Rule and the impact that it is having on both the Democratic Republic of the Congo as well as all the affected industries, including retail.

U.S. retailers have taken their responsibilities under the Conflict Minerals Law very seriously. Retailers and other businesses have developed and instituted due diligence and compliance programs to meet their obligations under the Rule. However, despite dedicating significant resources to these programs, retailers continue to face substantial challenges in this effort. Conducting an analysis as to whether a company must file a conflict minerals disclosure is an extremely complex and costly endeavor. The downstream effects on foreign suppliers has also been problematic, requiring redundant and costly audits to prove that conflict minerals do not exist in products that they produce.

The Conflict Minerals Law has imposed a set of mandates on U.S. business that requires an unprecedented degree of analysis to determine whether a product may be covered by the law. If so, the company must conduct supplier due diligence, including inquiries potentially back to the source of the minerals, and obtain certifications at all appropriate points in a product's supply chain. This imposes an obligation on retailers and their suppliers to achieve a degree of supply chain visibility that they do not possess, and cannot acquire with any reasonable degree of certainty. Retailers do not source the ores or metals in question from either mines or smelters. Retailers seldom specify the mineral make-up of the products they order. They rely on their suppliers, their suppliers' component manufacturers and their sub-suppliers to determine if, when, and how tin, tantalum, tungsten, or gold (3TG) may be necessary for the product the vendor is manufacturing. As such, retailers have no direct relationship, contractual or otherwise, with those entities procuring the ores or metals who are often multiple steps down the supply chain from the final product as sold in a store.

Given the complexity of the global supply chain and the fact that there are many points along the chain of custody before the final product containing the metals in question reaches the retailer, as we expected, many retailers who are required to file with the SEC have concluded that they are unable to determine the source of any tin, tungsten, tantalum, or gold that may be in their products.

We believe that the evidence of the effectiveness of the Conflict Minerals Law remains incomplete. The SEC should undertake an effort to analyze the overall effectiveness of the law as well as the true financial cost of implementation and compliance. While we recognize the severity of the human rights issue that the law aims to address, there may be better options to apply it to those companies who directly import tin, tungsten, tantalum, or gold (3TG). These

companies will both have greater leverage with smelters, refiners, and mines and are more likely to apply the appropriate resources to manage what is a more material business risk.

In addition, the SEC should also review how the European Union has addressed the issue of conflict minerals. We encourage harmonization among the EU and US efforts which may promote greater compliance if mines, smelters, and 3TG importers have only one set of rules to follow.

There are two issues in particular that continue to be a burden for the retail industry with regards to compliance that we believe need to be addressed. These include the definitions of "Manufacturer," "Contract to Manufacture," and "Necessary to the Functionality or Production of a Product," and their applications to the retail industry.

Definition of "Manufacturer" and "Contract to Manufacture"

Although the statute itself is clear that only ***manufacturers*** are subject to the obligation to report on the products that they either manufacture themselves or "contract to manufacture," there was considerable debate over whether and how the terms "manufacture" and "contract to manufacture" should apply to retailers who sell consumer products containing conflict minerals. Some suggested that retailers are not manufacturers and should be entirely exempt from the law. Others argued that while "pure retailers" who have no influence over a product's manufacture should be exempt, the law should apply to retailers who "issue [unique] requirements for products to be manufactured for them – including design, quality, product life-expectancy, and so on."

Even if non-manufacturers are to continue to be covered by the rule, we believe that, for a company to fall within the scope of the conflict minerals rule as a "manufacturer" of products containing conflict minerals or a party "contracting to manufacture" goods containing conflict minerals, that party must maintain <u>substantial</u> control over the manufacturing process. Substantial control should be limited to instances where the issuer has direct, close and active involvement in the specifications and sourcing of materials, parts, ingredients, or components to be included in that product that may contain metals smelted from conflict minerals. The mere act of placing an order for a finished product to be affixed with a private label of the party placing the order, or specifying only certain capabilities, appearance, configurations, or performance should not constitute "manufacturing" or "contracted to be manufactured" within the meaning of the statute.

Definition of "Necessary to the Functionality or Production of a Product"

Under the conflict minerals statute, the reporting requirements apply only to those subject minerals that are "necessary to the functionality or production of a product." We believe that a definition of the phrase is necessary and appropriate to guide companies in determining whether a subject metal does or does not fall under the reporting requirements of the statute. If a metal produced from the subject minerals is a part of, or contained in a product, but is not necessary to the functionality or the production of that product, then the issuer should not be subject to the reporting obligation.

We believe that a metal produced from a subject mineral should only be considered necessary to the functionality of a product if it is (1) specified as a necessary raw material or intentionally added to the product, and (2) it is essential to the product's basic function, use, or purpose. This definition would necessarily exclude minerals that are naturally occurring, are an unintentional by-product, or do not appear in the final product.

Credit Card Transactions

Prior to the passage of Dodd-Frank, the costs associated with networked debit card transactions were not subject to true market competition. The problem was made worse by a lack of transparency.

Debit interchange fees were centrally fixed. As a consequence, every one of the more than 100 largest banks ultimately charged merchants exactly the same high rates for interchange fees. Year in, year out, all those banks consistently raised their identical fees by the same amount at the same time.

In addition, in the years immediately preceding the passage of Dodd Frank, the capacity for competitive routing of those transactions over more than a dozen robust networks was systematically being removed from the market by the actions of the dominant debit card players.

Market failures also were occurring in the credit card market. As a result, consumer prices were being forced up by the escalating fees. Main Street merchants in particular were being harmed, and card company rules effectively prohibited merchants from showing their customers the escalating costs of cards, which amounts to hundreds of dollars per year for the average household.

Section 1075 of Dodd-Frank enacted provisions designed to partially address these market failures, focusing on debit cards but also providing minor relief for credit cards as well. These are the three primary provisions.

1. For banks that continued to link arms and charge the same centrally fixed debit card interchange fees in lieu of competition, the Federal Reserve was ordered to develop standards that ensured those fees were reasonable and proportional to their actual cost. If a bank chose to unlink arms and compete independently, it would not be governed by the Fed standards and could charge whatever price the open market would accept.
2. To counter the fact that banks were being paid to eliminate the connectivity necessary for regional or smaller innovative networks to compete for the ability to route transactions, the law required that access to at least two unaffiliated networks be available for every debit transaction.
3. The law took a first step toward transparency by allowing merchants to set a minimum purchase amount for credit cards of up to $10. It did so by overturning card

company rules that effectively prohibited merchants from doing so. This gave merchants the ability to suggest to consumers the high costs involved in accepting credit cards. And by moving some transactions away from credit cards, it ameliorated some of the credit card costs merchants (and ultimately consumers) bore.

These reforms have significantly improved the market.

As to routing, the competitive networks have increased their market share by offering services the dominant legacy players had not, such as less downtime, encrypted transactions to better protect merchants and their customers from breaches, and lower prices. As to debit interchange, the law has produced lower fees across the board, saving merchants and their customers more than $40 billion even while providing the regulated banks a 500 percent markup above their costs as calculated by the Fed. In addition, the incentives to compete outside the centrally fixed system have already induced one money center bank to offer an array of competitive services outside the Fed requirements that are mutually beneficial to merchants, their customers, and the bank. Finally, the freedom to post minimum credit card purchase signs has particularly helped small merchants. Low-dollar purchases are among the costliest to process, with the card fees often higher than the profit on the products sold.

Suggestions for Change

A. The law's limited foray into debit reform has largely been a success. It has saved consumers billions of dollars. (For example, studies have shown that widely transparent gasoline prices result in vigorous competition. Gasoline prices at the pump track underlying costs nearly perfectly. The savings to station owners when interchange fees drop have allowed them to lower prices by several cents a gallon. That is one of many genuine consumer benefits.)

   The Committee should explore ways to extend the benefits of increased transparency and enhanced incentives for competition to currently price-fixed credit cards. There is no rational reason why entrepreneurial networks should not be allowed to route credit transactions that dominant credit networks would like to preserve just for themselves; than there was a rational reason why entrepreneurial phone networks were for years not allowed to carry long distance calls that Ma Bell wanted for itself. A phone call is a phone call. A credit card transaction message is a credit card transaction message. The biggest players ought not to be allowed to blunt innovation and stymie this market.

   Dodd-Frank has already demonstrated that competitive networks can route debit card transaction messages as fast, safer, and more cheaply than can today's Ma Bell equivalents. Competition in credit card routing would be a modest but important step toward a more robust, diverse, and redundancy-protected financial system.

B. Transparency works. When consumers and businesses have more information as to what they paying, competition is facilitated and markets function better as a result. Currently, banks must disclose the annual percentage rate associated with a loan, but

the amount of the interchange fee of particular credit cards remains hidden from merchants until several days after a transaction, at which point it is of no value. And it remains absolutely hidden from consumers. Yet, these inflationary fees cost the average household more than $400 annually even if the consumer doesn't carry a balance.

Since they are hidden and shrouded in card company rules, merchants also effectively are blocked from conveying these costs to their customers or taking additional steps to move the market toward more cost-effective options. Free markets thrive on transparency and incentives to compete. Other nations have taken steps to limit the damage done when both those elements are suppressed. We should reward businesses who compete openly and disfavor those who do otherwise. Such a carrot-and-stick approach to increased credit competition, as has been successful with debit, is one avenue that should be considered as the Senate looks at ways to reform Dodd-Frank.