FDIC
FEDERAL DEPOSIT INSURANCE CORPORATION

NEWS RELEASE

FOR RELEASE ON DELIVERY PR-72-73 (10-29-73)

Statement by

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before the

Subcommittee on Consumer Affairs
of the Committee on Banking and Currency

House of Representatives

October 29, 1973

I am pleased to appear today before this Subcommittee to testify regarding the Federal Deposit Insurance Corporation's enforcement of the Truth in Lending Act. I shall also discuss briefly the recommendations of the National Commission on Consumer Finance and the proposed amendments to the Truth in Lending Act (S. 2101) passed by the Senate on July 23, including a provision therein which would prohibit discrimination on the basis of sex or marital status in the granting of credit. Finally, I shall discuss certain ways in which we believe the Fair Credit Reporting Act might be improved.

FDIC'S TRUTH IN LENDING ENFORCEMENT ACTIVITIES

The FDIC has enforcement responsibility under the Truth in Lending Act with respect to insured banks which are not members of the Federal Reserve System. Primary responsibility for enforcing compliance with Truth in Lending requirements has been assigned to the Regional Directors in charge of our 14 regional offices, as part of their overall examination and supervisory responsibilities. In addition, we have established in our Washington Office a Consumer Affairs Unit in the Division of Bank

Supervision to coordinate our regional enforcement efforts and to process inquiries, requests, and complaints directed or referred to our Washington headquarters. The legal staff in our Washington Office and our seven Regional Counsel also routinely assist in handling Truth in Lending matters and are available as needed for special enforcement problems.

Our field examiners check for compliance with Truth in Lending requirements as a part of all regular examinations of State nonmember banks. Since we try to examine each such bank once each year, this means that virtually all State nonmember banks are checked annually for compliance with Truth in Lending requirements. In order to facilitate checking for compliance in an organized and efficient manner, we have furnished each examiner with a checklist to be used as a reference and guide. This checklist contains some 46 questions covering a wide range of areas in which Truth in Lending violations may exist.

During the course of an examination, our examiners review a sufficient number of credit transactions in various categories to give a fair indication of whether the bank is complying with applicable statutory requirements, including those of the Truth in Lending Act. When violations of Truth in Lending requirements are discovered, they are handled in one of two ways. In many cases, our examiners will simply point out the violations found and the bank's management will make the necessary corrections before the examination is concluded. On the other hand, if the violations found are not resolved informally during the examination or appear more extensive, the examiner in charge will prepare a letter report, addressed to the bank's board of directors, listing the various violations found and requesting correction and requiring advice as to steps to be taken to avoid similar violations in the future. This letter report is forwarded with the completed report of examination to our Regional Office for review. It is then sent by our Regional Director to the bank involved and routinely followed-up as a part of his ongoing supervisory effort to secure recommended improvements and correction in the bank's policies and practices.

As a result of such letters, corrections are normally obtained. In point of fact, we recently surveyed our Regional Offices by telephone requesting the name and location of any banks in which violations of Truth in Lending regulations have been reported by letter-report to the bank's board of directors through September 15, 1973, and where the Regional Director has not been satisfied that compliance has been effected. The survey indicated that 36 banks were receiving follow-up action because the Regional Director was not satisfied with the bank's compliance with the Truth in Lending law. Of the 36 banks, two are in an exempted State and are also the subject of follow-up action by that State's banking department. Follow-up action being taken by the

Regional Offices includes continuing correspondence and scheduling of special reviews of Truth in Lending compliance at upcoming examinations of the banks. Depending upon the results of this follow-up activity, the Regional Directors may take other action to obtain compliance.

In all cases such as these, we make every effort to obtain corrections voluntarily. Nevertheless, if it becomes apparent that corrections cannot be obtained voluntarily, we may initiate administrative proceedings to issue a cease-and-desist order against any further violations. Such an instance occurred recently when the examination of a bank revealed that the bank had failed, after repeated efforts by the Corporation to obtain voluntary compliance, to correctly disclose the annual percentage rate to its borrowers, to disclose finance charges, to disclose the number, amount, due dates, and/or periods of payments scheduled to repay the indebtedness, and to accurately disclose the amount financed -- all in violation of Truth in Lending requirements.

An order to cease and desist such violations was issued by the Corporation and the bank consented without admitting or denying the charges. The order requires the bank to make all necessary Truth in Lending disclosures at the time and in the manner and form required by the law and regulations issued thereunder. In addition, the bank must review all outstanding extensions of credit and deliver to each customer a notice containing the required disclosures. We are working closely with the bank involved and we believe that they are making every reasonable effort to comply with the substance of the order. Violation of such an order is enforceable in the United States District Court in the district in which the bank is located.

In addition to administrative enforcement proceedings, we routinely refer possible criminal violations of Federal laws to the Department of Justice. This is normally done through letter reports to the appropriate United States Attorney outlining the basic facts as we know them and indicating the individuals and the statutory provisions believed to be involved.

As you know, under the Truth in Lending Act, the Board of Governors of the Federal Reserve System may exempt from the requirements of disclosure any class of credit transactions within any State if it determines that under the laws of that State that class of transactions is subject to requirements substantially similar to those imposed under the Federal law, and that there is adequate provision for enforcement. Under this authority, the Board has exempted various classes of credit transactions in the States of Connecticut, Maine, Massachusetts, Oklahoma, and Wyoming. As a result, State nonmember banks in such States have become subject to disclosure requirements under State law substantially similar to the disclosure requirements under the Federal Truth in Lending law. Consequently, enforcing compliance with Truth in Lending in these States is now a matter of enforcing applicable State law. Primary enforcement responsibility in this regard rests with those State authorities specifically charged with it under State law. Nevertheless, we continue our efforts to assist in the enforcement of Truth in Lending requirements in those States which have received exemptions from the Federal law.

We refer Truth in Lending complaints and violations to other Federal and State enforcement agencies in accordance with established procedures. On a State level, our Regional Directors cooperate closely on enforcement matters with the various banking authorities of the States located in their regions. As a result, all our Regional Directors furnish to the appropriate State banking authority copies of all letter reports prepared by our examiners listing Truth in Lending violations discovered in State nonmember banks located in their States.

Truth in Lending violations discovered by our examiners which involve creditors committed to the enforcement jurisdiction of some other Federal agency are reported by letter to that enforcement agency. This may occur, for example, where during the course of checking automobile dealer paper purchased, our examiners note apparent violations of

Truth in Lending. In such case, the matter would be reported by letter to the Federal Trade Commission.

Truth in Lending involves a rather complex law and even more complex regulations. This complexity makes the law difficult to understand, and it is therefore difficult for bank officers and employees to gain a familiar working knowledge of its numerous, rather specific requirements. However, through our repeated examination checks, criticism of violations found, and the advice and guidance we furnish, we believe we are making realistic progress towards the goal of substantially complete overall compliance, insofar as State nonmember banks are concerned.

REPORT OF THE NATIONAL COMMISSION ON CONSUMER FINANCE

Because of the breadth of the report of the National Commission on Consumer Finance, we shall confine our comments thereon primarily to issues of special importance to the FDIC in Chapter 4 relating to supervisory mechanisms and Chapter 7 relating to the rates and availability of credit.

We note that many of the recommendations in Chapter 3 of the Commission's Report dealing with contract provisions and creditors' remedies are similar to comparable recommendations in the November 1972

Report of the Sub-Council on Credit and Related Terms of Sale of the National Business Council for Consumer Affairs. We generally support the objectives of these recommendations. Specifically, we might add that, with respect to the proposal in currently pending fair credit billing legislation limiting the applicability of the holder-in-due-course (waiver-of-defense) doctrine in credit card transactions, the Corporation favors eliminating this doctrine as applied to bank credit card transactions above a reasonable dollar minimum, so long as the merchants involved are within the market area of the card issuing bank -- in line with the concept underlying § 170 of S. 2101.

Perhaps the most significant feature of Chapter 4 of the Report is the recommendation that Congress establish a new governmental agency, the Bureau of Consumer Credit, with authority to issue substantive rules and regulations and to supervise all examination and enforcement functions under the Consumer Credit Protection Act, including the Truth in Lending Act. Among other powers, the new BCC could (1) require State and Federal agencies that supervise institutions which grant consumer credit to submit written reports, (2) require by subpoena the attendance and testimony of witnesses and the production of all documentary evidence relevant to the execution of its duties, and (3) intervene in corporate mergers and acquisitions which might lessen competition in consumer credit markets, as well as in proceedings for the granting of new charters and the approval of new offices and branches.

We believe that before creating yet another Federal agency with functions similar to and overlapping those of a number of existing agencies, such as the Federal agencies regulating financial institutions and the Federal Trade Commission and the Department of Justice, every effort should be made to accomplish the Commission's objectives within the existing regulatory structure. We believe the Commission's goals could be realized by (1) mandating a single financial regulatory agency (such as the Federal Reserve, the FDIC or the Federal Home Loan Bank Board) to issue substantive regulations in the consumer protection area, and (2) conferring jurisdiction to enforce such regulations upon all agencies regulating financial institutions. This approach would achieve uniformity of substantive consumer protection rules applicable to financial institutions, while at the same time taking advantage of the existing supervisory structure to obtain optimum enforcement results.

We believe that, with a clear mandate from the Congress, the existing financial regulatory agencies are willing and able to undertake a vigorous and sustained effort to promulgate and enforce regulations designed to protect consumers transacting business with financial institutions. In our opinion such a consumer protection program is consistent with the need to maintain a sound financial system, and we believe the goal of protecting customers, depositors and shareholders of financial institutions and the public in general can be achieved most effectively by the financial regulatory agencies under appropriate congressional directives. We would prefer to avoid further proliferation of regulatory agencies at the Federal level until the existing financial regulatory agencies have been given a broad consumer protection mandate by Congress and have then been shown to have failed effectively to implement such mandate.

With particular reference to the BCC's proposed right to intervene in existing procedures for approving bank mergers, we would note that these procedures are already quite detailed, in that the Department of Justice and other financial regulatory agencies are required to furnish advisory opinions on the competitive factors involved in each such merger to the regulatory agency with decision-making authority. Also, it may be pointed out that the competitive impact on relevant consumer credit markets is required to be taken into account in connection with all bank mergers under existing law.

We concur in the Commission's recommendation in Chapter 7 that the regulatory agencies disallow mergers or stock acquisitions among financial institutions where the result would be a substantial increase in concentration in <u>State</u> as well as local markets. The proposition that statewide concentration data are relevant in analyzing mergers represents an emerging antitrust concept endorsed by the Corporation.

We also generally favor the Commission's recommendations on steps to be taken to assure easier entry than at present into the consumer credit market. Permitting banks to make small loans by establishing _de novo_ offices through subsidiaries or affiliated entities operating under the rate structure permitted for finance companies seems generally preferable from the competitive standpoint to the acquisition by banks of existing finance companies. Such acquisitions could foreclose potential direct competition while the gains achieved by the merger of creditor institutions, such as scale economies and risk diversification, would seem to be equally available through _de novo_ entry by banks into the small loan business.

The Commission also recommends in Chapter 7 that "restrictive arrangements" in the credit industry should be vigorously pursued and eliminated. Practices such as "tie-in" arrangements, territorial allocations, discriminatory pricing, and price-fixing often have serious anticompetitive effects. We agree with the Commission's conclusion that these practices should be vigorously pursued and eliminated wherever they exist in the credit industry.

TRUTH IN LENDING ACT AMENDMENTS OF 1973

S. 2101 contains provisions designed to help consumers resolve credit billing disputes in a fair and timely manner and to prohibit certain other practices arising out of consumer credit transactions. The bill also incorporates a series of needed technical amendments to the Truth in Lending Act. Although we generally support these portions of the bill, I will not take the time to discuss them in detail here today. Rather, I would like to focus upon three important and perhaps controversial issues involved in this proposed legislation.

First is the question of limitations on class action liability for violations of the Truth in Lending Act. The bill as passed by the Senate would impose a limitation of the lesser of $100,000 or one percent of the creditor's net worth. The Federal Reserve, on the other hand, recommends that the limitation be the greater of $50,000 or one percent of net worth. In his testimony before this Subcommittee last July, Mr. Frederic Solomon, Director of the Federal Reserve's Division of Supervision and Regulation, stated that it might very well be better to sacrifice the bill than to accept the Senate-passed limit on class action liability.

Perhaps the single most important factor encouraging creditors to comply with Truth in Lending requirements is their concern about potential class action liability for violators of the Act. In our opinion, a maximum liability of $100,000 in a class action suit against the largest insured banks would be an ineffective deterrent to violations of the Truth in Lending Act. We would therefore concur with the Federal Reserve on this point and would strongly recommend that the bill set the class action liability limit at the greater of $50,000 or one percent of net worth.

Our second major point in connection with this proposed legislation involves the omission from S. 2101 of any provision dealing with the method for computing finance charges on open end credit accounts. S. 914, 93d Congress, another version of this proposed legislation, contains a provision (§ 167) which would prohibit the retroactive assessment of a finance charge against any balance outstanding in the card holder's account prior to the time by which payment must be made in order to avoid imposition of a finance charge. In effect, § 167 would abolish the use of the previous balance and the average daily balance methods of assessing finance charges.

Although we believe the previous balance method of computing finance charges unfairly imposes a finance charge on that portion of the credit balance which is paid during the current period, we believe there is merit in retaining the option of using the average daily balance method, with one qualification -- namely, that purchases made during the current billing cycle be excluded from the computation of the average daily balance, thus providing a "free period" for current purchases. This is the approach recommended in FTC Chairman Engman's May 22, 1973 statement before the Subcommittee on Consumer Affairs of the Senate Committee on Banking, Housing and Urban Affairs.

The third major point we wish to specially note is the question of discrimination on the basis of sex or marital status in connection with consumer credit transactions. Title III of S. 2101 would prohibit discrimination on either of these bases in connection with "the approval or denial of any extension of consumer credit or with respect to the terms thereof or with respect to the approval, denial, renewal, continuation, or revocation of any open end consumer credit act or with respect to the terms thereof." We strongly support including a prohibition of this type in the bill, but we would recommend that it be expanded to also prohibit discrimination in consumer credit transactions on the basis of race, color, religion, or national origin. Additionally, we would recommend that a single Federal supervisory agency such as the Board of Governors of the Federal Reserve System, the FDIC or the Federal Home Loan Bank Board, be expressly granted general substantive rulemaking authority to implement these prohibitions in a manner consistent with the property laws of the various States, such substantive rules then to be enforced by each appropriate Federal agency with respect to financial institutions under their supervisory jurisdiction.

With amendments as suggested in these three areas, we would favor enactment of a bill along the lines of S. 2101.

FAIR CREDIT REPORTING ACT

Our experience with the Fair Credit Reporting Act as it relates to State nonmember banks leads us to recommend the following changes in the Act:

1. Consumer Reporting Agency Disclosures

At present, section 609 of the FCRA merely requires that upon request, a consumer reporting agency must "disclose" to the consumer "the nature and substance of all information (except medical information) in its files on the consumer . . ." This does not entitle the consumer to actually see his file and determine for himself what it contains. Instead, the contents of the file are read by an employee of the reporting agency to the consumer who must take notes on what is said to him.

We recommend that the FCRA be changed to permit the consumer to personally inspect his file, take notes regarding its contents or, for a nominal fee, make copies of the material in his file. This would permit the consumer who has a personal interest in the matter to see and judge for himself the accuracy and completeness of the information contained in his file and give him access to the details of that information, which may be significant, rather than merely the "nature and substance" of the information.

2. Investigative reporting authorizations and disclosures

At present, section 606 of the FCRA merely requires that a person who orders an investigative report on a consumer inform him that such a report "may be made" and further inform him of his right to make a written request as to the "nature and scope" of the investigation requested. If the consumer is interested, he may thereafter inquire as to the "nature and scope" of the investigation (but not the information developed).

We recommend that no investigative consumer report be prepared without a specific authorization from the consumer. This approach would protect the consumer's right of privacy and give him the right to decide whether he wants the related benefit enough to allow a private agency to delve into his personal affairs.

3. User Disclosure

At present, users of credit information are required to disclose only the name and address of the credit bureau whenever adverse action is prompted by a consumer report. The user is not required to furnish the consumer with a copy of the report prompting that action. Nor is the user required to explain why the adverse action was taken or identify the information responsible. We recommend that the user be required to furnish the telephone number of the credit reporting agency in addition to its name and address.

The Federal Trade Commission has recommended that the user be also required to furnish the consumer with a copy of the consumer report, explain the reason for the adverse action taken and identify for the consumer the information in the report responsible for the adverse action. We question the propriety of placing upon the user the burden of furnishing a copy of the report, requiring the user to explain his reason for taking adverse action and compelling him to identify the information responsible. If a consumer wishes to correct inaccurate or incomplete information in his credit file, he may do so by reviewing his file at the credit reporting agency. Requiring the user to furnish the name, address, and telephone number of the credit reporting agency seems sufficient to permit the consumer to make whatever corrections are necessary and to satisfy the basic purpose of the FCRA. To require the user to explain why the adverse action was taken and to identify the information responsible seems to go beyond the purpose of the FCRA and to be unnecessarily burdensome to the user. If the user is a bank, for example, which has ordered a credit report for the purpose of evaluating a consumer's loan application, to require the bank to explain to the consumer why his loan was turned down will likely simply generate conflict over the merits of the credit judgment.

4. Civil Enforcement of FCRA

At present, section 617 of the FCRA limits liability for negligent noncompliance to the actual damages sustained by the consumer, plus costs and reasonable attorney's fees. It is, of course, very difficult to prove actual damages given the nature of the injury. Moreover, the fact that not one dollar of damages has ever been officially awarded to a plaintiff in a civil suit brought under the FCRA is cogent evidence of the inadequacy of existing provisions. We believe that allowance for the recovery of some type of penalty is essential both as an incentive to private enforcement action and to encourage care in complying with the FCRA on the part of those subject to it. We therefore recommend a $100 minimum penalty for negligent noncompliance recoverable in individual action, with maximum liability in a class action limited to the greater of $50,000 or one percent of the defendant's net worth, as recommended earlier with respect to Truth in Lending violations.