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Statement by

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On behalf of the Board of Governors, I wish to express our appreciation for having this opportunity to comment on the report of the National Commission on Consumer Finance, entitled "Consumer Credit in the United States." The Commission was created by Congress to "appraise the functioning and structure of the consumer finance industry" and to consider, among other things, the "adequacy of existing arrangements to provide consumer credit at reasonable rates." The subject is an important one, and the report merits careful attention.

Because of the breadth of the report, the Board's comments will focus on those issues which appear of special importance or which bear directly on the Board's activities. The first section of my testimony will deal with the report's recommendations aimed at strengthening competition. Following this discussion will be successive sections on interest rate ceilings, supervisory mechanisms, the electronic funds transfer system, and Truth in Lending.

Strengthening Competition

Among the numerous recommendations in the report are several that are linked to the premise that the best means of assuring adequate credit for consumers at reasonable rates is to make the markets for such credit more competitive. The Commission concluded that some of the laws and regulations designed to protect consumers, particularly at the State level, have had the unintended effect of inhibiting competition in the granting of consumer credit and of needlessly segmenting credit markets. The Commission therefore urges a careful review of present laws and regulations with a view toward eliminating impediments to competition among suppliers of consumer credit and achieving, insofar as consistent with other policies, the broadest possible penetration by all credit grantors in all fields of consumer credit.

The Board shares the view stressed in the report that we should rely basically on vigorous competition to provide optimal performance in terms of the price and availability of consumer credit. This was an important consideration in the shaping of the 1970 amendments to the Bank Holding Company Act, and the Board has had this principle very much in mind in carrying out its responsibilities under that Act.

We have authorized bank holding companies to establish subsidiary finance companies, and we have established procedures that encourage de novo entry. Applications for such entry are processed by the Reserve Banks under delegated authority. They are approved 45 days after the Reserve Bank receives a copy of a notice of the proposal published in newspapers in the communities to be served, unless the Reserve Bank determines that adverse factors require more careful scrutiny of the application. In that event, the application is processed under the procedures applicable to acquisition of going concerns, which require more time to complete.

As we read the report, it seems to suggest that where the possibility for _de novo_ entry exists, as is now the case for bank holding companies, entry by acquisition of an existing finance company should be prohibited. The Board believes such an unequivocal prohibition would be unnecessarily restrictive, and inconsistent with the intent of Congress in enacting the 1970 amendments to the Bank Holding Company Act. Although the Board's procedures encourage _de novo_ entry, we believe that acquisition of an existing company in specific instances may also be pro-competitive. We have denied applications to acquire existing companies that compete significantly with the applicant in geographical areas they already served. Perhaps because most applicants are aware of the Board's pro-competitive policies, however, most of the applications that have come before the Board to acquire existing finance companies have involved companies that serve markets geographically separated from those served by the applicant. In the few cases approved that did involve an overlap, the companies acquired had market shares so small as to rule out the possibility of an adverse effect on competition.

When no significant amount of existing competition would be eliminated, acquisitions of existing companies can be pro-competitive. For example, affiliation with the holding company may assist the acquired company in raising the funds it needs to compete more vigorously for additional customers and in recruiting and retaining competent, aggressive management. Moreover, once a bank holding company moves into new territory via an acquisition, it may start de novo offices from the foothold it has acquired. Thus, a bank holding company in North Carolina may gain the Board's approval to acquire a consumer loan firm in Texas, then might proceed to enlarge its subsidiary's operations in Texas through de novo expansion. Substantial new competition can result from such a process. The Board believes, therefore, that entry de novo and, under appropriate circumstances, entry by acquisition, should continue to be allowed in order to achieve the Commission's goal of promoting competition.

The Board agrees with the Commission that competition in consumer lending markets should be strengthened by permitting savings and loan associations and mutual savings banks to make consumer loans. Relaxing restrictions on the lending powers of thrift institutions would also improve the stability of their earnings during periods when rising market interest rates may necessitate increases in the rates they must pay on deposits. But in expanding consumer lending powers for thrift institutions care must be taken to avoid a serious shrinkage in the funds available for mortgage lending. This risk could be lessened by limiting the percentage of assets these institutions may devote to consumer loans along the lines suggested by the Commission, possibly with provisions for a gradual phasing-in of the broader lending powers.

Besides encouraging entry by savings and loan associations, mutual savings banks, and finance companies affiliated with banks, the Commission recognizes the need to stimulate stronger interest on the part of banks themselves in making small personal loans. Although some banks are active in this market, the industry as a whole has a clear opportunity to improve services to consumers by making more loans of this type. This has been one reason why the Board has denied applications by bank holding companies to acquire finance companies that would serve the same market as the subsidiary banks. It should be recognized, however, that banks are likely to show only minimal interest in entering this business in States where applicable rate ceilings are low relative to the cost of making the loans.

Rate Ceilings

Throughout the report, there is considerable emphasis on the unfavorable effects of rate ceilings in markets for consumer credit. The report's pro-competitive recommendations seek to achieve, through a series of related steps, a market in which interest rates will be held to reasonable levels by competitive forces rather than legal ceilings. The Board recognizes that judgments differed among Commission members as to when or whether rate ceilings should be raised or removed, but we agree with the Commission's recommendation that "Policies designed to promote competition should be given the first priority, with adjustment of rate ceilings used as a complement to expand the availability of credit." As has been amply demonstrated in the mortgage market, rate ceilings tend to divert funds away from the controlled sector of credit if they are too low relative to other market rates. In implementing the Bank Holding Company Act, the Board is encouraging entry of new lenders into the field, and we can hope that as the number of strong and viable competitors grows through this and other measures, rate ceilings ultimately will become unnecessary in some States. If that proves to be the case, perhaps other States will be moved to evaluate the competitiveness of their markets, as the report urges, and to consider whether modification or removal of their ceilings could strengthen competition.

Supervisory Mechanisms

The report of the Commission recognizes a growing public interest in obtaining fair and effective remedies for abuses in the consumer credit field. Congress has responded to this public interest by enacting measures such as the Truth in Lending Act. The Board of Governors supported this initiative in the belief that it not only protected consumers, but also helped to make credit markets more responsive to competition. Needless to say, Congressional concern about consumer problems is also reflected in the actions of agencies of government, including our Board. The Board's role in the conduct of monetary policy reflects our concern for consumers in a broad sense, but we are involved in more direct efforts, such as in prescribing Truth in Lending regulations. Moreover, we recognize the need to pay increasing attention to the interests of consumers in connection with the supervision of banks.

The Commission questions whether an agency that supervises banks, and thus tends to fucus on issues of maintaining soundness and solvency, is capable of broadening its outlook sufficiently to give proper consideration to consumers. The Board believes it is entirely possible to reconcile the need to maintain sound, strong banks with the need to ensure that banks are treating their customers fairly.

We recognize, however, that the Commission's question is a valid one, shared by others who are concerned with consumer protection, and it therefore deserves serious consideration. It may be useful in this connection to mention at this point a few examples of actions by the Board to protect consumers and improve the financial services available to them. These examples are not offered in a spirit of self-congratulation, although we are proud of our record, but rather to indicate the strong similarities between the goals of the Commission and those of the Board.

Let me first say a word about the Board's implementation of the Truth in Lending Act.

We have been pleased over the years to have learned from various members of Congress of their satisfaction with the job the Board has done under that legislation. The most demanding aspect of this assignment has been the drafting of appropriate regulations to implement the Act. Some of the Board's actions have necessarily produced disagreement, and occasionally litigation. In one example of the latter, the Board was extremely gratified recently when the U. S. Supreme Court upheld the "more-than-four-instalment rule" issued under Truth in Lending. Recognizing that the Act contained a potential loophole which permitted retail creditors to bury credit costs in their cash prices and thereby defeat the congressional purpose of the Act, the Board amplified the Act's definition of consumer credit by requiring Truth in Lending disclosures in any obligation repayable in more than four instalments. The Board's action in this regard was criticized by some persons as reflecting an unduly paternalistic attitude toward the consumer. But the Board felt the rule was needed, and we are naturally pleased to see that view vindicated.

Although our primary responsibility is the issuance of regulations implementing the Act, we have also felt that an important corollary to the rulemaking function is public education. Two special educational efforts are worth mentioning here, one being the production and distribution of the pamphlet, "What Truth in Lending Means to You." Over three million copies of this pamphlet have been distributed in the English language version, another half-million in a Spanish language edition. The Board also has available for distribution without charge an informational package on Truth in Lending that has been extremely popular with schools, both at the high school and college level.

Aside from Truth in Lending, however, there are other activities of the Board on behalf of consumers which I believe are too often overlooked. In acting on holding company formations and acquisitions, for example, one of the crucial decisional factors is the extent of public benefits which can be expected to flow from each application. The Board is very much aware of the importance of such decisions in fostering a competitive banking system that will serve consumers better.

It may be helpful, as well, to cite examples of specific Board actions to correct abuses or improve financial services to the public. Recently, the Board ruled (1973 Bulletin 19) that applications by a bank holding company to underwrite credit life and credit accident and health insurance will be approved only if the applicant demonstrates that benefits to the consumer or other public benefits will ensue. Such a showing normally is made by a projected reduction in rates, or increase in policy benefits, due to bank holding company performance of this service.

In 1970, in an action to help savers, the Board issued an interpretation to its Regulation Q (1970 Bulletin 279) requiring member banks to inform their customers who maintain time or savings accounts of the methods used in the computation and payment of interest on those accounts. The interpretation provides that if a member bank makes a change in its methods that will be less favorable to the depositor, then notice of the change should be mailed to each depositor at his last known address.

Moving to the Commission's recommendations in the supervisory area, the report proposes that Congress create a Bureau of Consumer Credit "to issue rules and regulations and supervise all examination and enforcement functions under the Consumer Credit Protection Act, including Truth in Lending." This proposal would entail overlapping responsibilities, potentially burdensome to financial institutions and troublesome for monetary policy and the evolution of the payments mechanism.

As an alternative, the Board recommends that a single bank supervisory agency be given the responsibility to write consumer protection rules affecting banks and other federally-supervised financial institutions. Through their long experience with the unique character of the institutions under their supervision, the Federal banking agencies possess the necessary background and expert knowledge to formulate rules sensitive to the complex roles of these institutions in the national economy while still providing protection for consumers.

If Congress disagrees with this approach, however, the Board believes it would be better to place the consumer-protection rule-writing authority affecting banks in an agency which deals with credit problems exclusively, such as the BCC, rather than extending the authority to an agency with more diverse consumer protection responsibilities such as the Federal Trade Commission.

The Board recommends against the Commission's suggestions that the BCC have authority to "supervise all examination and enforcement functions under the Consumer Credit Protection Act, including Truth in Lending" and that the BCC be authorized to intervene in agency actions on mergers, acquisitions, and other applications. Both of these proposals would be duplicative of functions now being performed by the Federal bank supervisory agencies. The practical effect would be to slow down the decisional process, and add to its cost. In addition, as you know, the Justice Department has statutory authority to offer comments on bank merger and holding company cases, and thereby supplements the Board's own strong interest in the questions of concentration and competition.

Holder-in-due-course Doctrine

The Commission recommends that the holder-in-due-course doctrine (HIDC) and waiver-of-defense clauses in consumer credit transactions be prohibited. It also proposes subjecting a lender to all claims and defenses of the borrower arising from the purchase of goods with the proceeds of a loan, if the borrower was referred to the lender by the vendor and he extended the credit pursuant to a continuing business relationship with the vendor.

Although there are differences of view among members of the Board on the broad issues raised by these recommendations, we would like to comment on the narrower question of how they should apply to credit cards.

The Board is seeking to encourage development of electronic transfer systems that will result in a more efficient payments mechanism, reducing the need for costly check handling. The credit card will probably play a key role in such a transfer system, and any limitations on the HIDC doctrine to protect consumers should be adopted with care so as not to impair the usefulness of the credit card as a means of payment. Two general principles may be useful in accomplishing this objective. First, for small transactions where credit cards are used as a convenient substitute for cash, we should avoid enlarging the purchaser's rights simply because he uses his card. Second, the liabilities of card issuers should bear some reasonable relationship to their ability to monitor performance by merchants whose sales they finance. These principles suggest that credit card issuers should be subject to cardholders' claims and defenses against merchants only where the transaction exceeds a dollar limit and takes place within the market area served by the issuer.

Electronic Funds Transfer System (EFTS)

The Commission's concern about the possibility of restraints of trade emerging as the payments system evolves toward the electronic transfer of funds is well taken. The Board shares this concern, and has taken positive steps to make its views known to Congress and the public.

The Board has outlined three general principles it believes should apply. First, so far as public participation and support are concerned, the Board believes there should be a single, integrated nationwide mechanism for efficient transfer of funds. The existing system, using checks and drafts, and functioning through commercial banks and the Federal Reserve Banks, is substantially of that character.

Second, even allowing for the existence of private clearing arrangements, the Board believes that the public system using check or electronic transfers of funds from one institution to another should be such as to insure that the conditions of entry into a general clearing arrangement are fair, and that equitable treatment is assured for institutions with similar powers and responsibilities. The presence of a public agency, such as the Federal Reserve, in any cooperative arrangement for transferring funds between institutions is one way of insuring the public interest will be taken into account, and that no private clearing arrangement may be used to protect or enhance the market position of the participating banks at the expense of others.

In taking this position, the Board recognized, as did the Commission, that whatever public action is taken, the innovative capabilities of banks and other financial institutions to improve money transfer services should be recognized and given opportunity for development.

Finally, the costs of the transfer system and the benefits of participating in it should be equitably distributed among all of the institutions involved. The Board believes in comparable treatment for financial institutions having like powers, but the existing situation does not meet this standard. Some institutions, namely, banks which are not members of the Federal Reserve System, have a competitive advantage because the reserves they may be required to carry are effectively earning assets: Government obligations and correspondent balances. Reserves maintained by member banks with the Federal Reserve, on the other hand, are nonearning assets. Nevertheless, nonmember banks are accorded certain Federal Reserve check clearing services deemed essential to the public's need for prompt money payment. If, in the future, extensive money transfer powers are developed for savings institutions, the extension of the benefits of the payments mechanism, whether conventional or electronic, to such institutions, without their assuming a fair share of the costs, would increase existing inequities.

Truth in Lending

We are gratified that a number of the Commission's suggestions mirror recommendations made by the Board in its annual report to Congress on Truth in Lending. For example, the Board has recommended for some time that large extensions of credit for agricultural purposes should be exempt, even though they involve a security interest in real property. Other business credit is exempt, and creditors argue that the very nature of many agricultural credit transactions (which often involve advances and payments for which both the time and amount are unknown at the time of the initial agreement) makes them unsuited for meaningful disclosure. The Commission recommends, as the Board tentatively suggested, that amounts over $25,000 should be exempt.

On the other hand, there are other recommendations with which we disagree. For example, the Commission would permit those who offer open-end credit, such as revolving charge accounts, to advertise only the periodic (monthly) rate and the annual percentage rate. The Board has outstanding a proposal which would trim the requirements of disclosure for open-end credit, but there are differences between the Board's proposal and the Commission's recommendation. For example, the Board thought the present statutory requirement that any "free-ride" period be shown is a good one, but the Commission would not include this requirement. Again, various revolving credit plans may feature the same annual percentage rate yet, because of differences in the calculation of finance charges, one plan may be more costly than another, so the Board has reservations about the value of disclosing the rate alone.

An appendix is attached to this statement commenting further on the Commission's proposals on Truth in Lending.

Conclusion

It is perhaps inevitable that judgments will differ regarding any set of proposals as wide-ranging as those of the Commission. But disagreement on specific proposals should not obscure the fact that the report represents a thoughtful and constructive effort to achieve a goal on which perhaps we can all agree--adequate flows of credit to consumers on terms that are fair and reasonable.

APPENDIX

I. Several suggestions made by the National Commission on Consumer Finance mirror recommendations made by the Board in its Annual Report to Congress for 1972.

More-than-four-instalment Rule

The Commission supported the Board's recommendation that the Act be amended to clarify its application to transactions which involve more than four instalments where there is no identifiable finance charge. The validity of the rule was recently upheld by the Supreme Court in Mourning v. Family Publications Service Inc., (4 CCH Consumer Credit Guide ¶ 99,034)

Agricultural Credit

The Commission recommended that exempted transactions (Section 104) of the Truth in Lending Act should include credit transactions primarily for agricultural purposes in which the total amount to be financed exceeds $25,000, irrespective of any security interest in real property.

In its latest Annual Report, the Board noted that the problems cited in previous Annual Reports relating to the coverage of agricultural credit under the Act continue to exist. Creditors argue that the very nature of many agricultural credit transactions (which frequently involve advances and payments for which both time and amount are unknown) makes them unsuited for meaningful disclosure. Furthermore, frequently it has been argued that since agriculture is a business, it should be exempt from coverage of the Act, just as other business credit is exempt. On the other hand, associations representing agricultural interests have a diversity of views regarding continued coverage of agricultural credit.

The Board again recommended that credit primarily for agricultural purposes in excess of an appropriate amount should be exempt from the provisions of the Act, irrespective of any security interest in real property. This recommendation, if adopted by Congress, would have the effect of removing from coverage large extensions of credit, where borrowers are more sophisticated and less in need of the disclosures, while still providing the benefits of disclosure to the smaller borrowers, who presumably are more likely to benefit from such disclosures. Such an amendment would benefit creditors in reducing the number of disclosures to be made. While the Board indicated that it believed an exclusion of transactions above $25,000 would alleviate the problem, it noted that opinions legitimately may vary about the appropriate amount.

Liens Arising by Operation of Law

The Commission supported the recommendation of the Board that Congress amend the Truth in Lending Act specifically to include under Section 125 security interests that arise by operation of law.

The courts have considered the question whether the right of rescission applies to such liens and have held that it does.[1/] Nevertheless the Board recommended that Congress amend the Act to clarify the coverage of these transactions under section 125.

1/ Gardner and North Roofing and Siding Corp. v. Board of Governors, D. C. Cir. 1972, 464 F2d 838; N.C. Freed Co. v. Board of Governors, 2nd Cir. 4 CCH Consumer Credit Guide ¶ 99,079.

Time Limitation on Rescission Right

The Commission supported the recommendation of the Board that Congress amend the Truth in Lending Act to limit the time the right of rescission may run where the creditor has failed to give proper disclosures.

Section 125 of the Act, implemented by section 226.9 of Regulation Z, provides that in some consumer credit transactions in which a security interest in the customer's residence is involved, the customer has three business days in which to rescind the transaction. To start the three-day rescission period, the creditor must notify the customer of his right of rescission and provide a form which may be used in exercising that right. The law does not set any limit on the length of time that the right continues where the creditor has failed to notify the customer of his right. Also, even though the required notice is given, there is a question whether the rescission period may continue where the other required disclosures of credit terms are given but are incorrect. As a result, the titles to many residential real estate properties may become clouded by uncertainty regarding unexpired rights of rescission. The Board recommended that Congress amend the Act to provide a three year limitation on the time the right of rescission may run.

Class Actions and Civil Liability

The Commission recommended adoption of the two suggestions of the Board pertaining to class action suits and of the clarification of the definition of "transaction."

Class Actions

The trend of the cases is away from allowing class actions for the enforcement of Truth in Lending. Very likely, this trend is an outgrowth of judicial concern over the possible magnitude of recovery by a large class, given the statutory minimum of $100 per person. While the Board indicated it shared this concern about possible liability, which might in some cases run into millions of dollars and may be disproportiate to any conceivable injury sustained by consumers, it also said it believed that potential class action liability is an important encouragement to the voluntary compliance which is so necessary to insure nationwide adherence to uniform disclosure. It believes that any inquiry into the justification for class actions should not be restricted to whether the possible liability in such suits exceeds the actual damages incurred by the class members. Equally important, in the Board's view, is the prophylactic effect of the threat of class action exposure. That threat elevates a possible Truth in Lending law suit from the ineffective "nuisance" category to the type of suit which has enough sting in it to insure that management will strive with diligence to achieve compliance.

While the Board believes that the class action vehicle in some form should be preserved for appropriate Truth in Lending suits, it is conscious of the difficulty of formulating an equitable rule which will preserve its effectiveness without, at the same time, exposing legitimate business to unwarranted claims in frivolous law suits. In its Annual Report the Board suggested that the best way to meet this problem was to set an upper limit on the aggregate amount of possible class action recovery (the greater of $50,000 or 1 percent of net worth is suggested in the Board's recommended amendment), while, at the same time, giving the courts the authority to set the amount of actual recovery within this limit in light of the circumstances of the particular case--for example, the severity of the violation and the size of the offender.

"Good Faith Reliance"

One of the legitimate concerns of creditors who have attempted to comply in good faith with the requirements of Truth in Lending is that, although they have followed Regulation Z, a court may conclude that the Regulation is invalid and that different disclosures or procedures were mandated by the Truth in Lending Act itself. At present, the civil liability provisions of section 130 do not necessarily preclude a finding of liability where the creditor has followed regulatory requirements which subsequently are held invalid. In order to avoid this inequity, a "good faith reliance" provision was suggested for inclusion in the Act.

Definition of "Transaction"

A final problem with section 130 of the Act is ambiguity as to the meaning of "transaction" to which the $100 minimum liability attaches where proper disclosures have not been made. While it is highly likely that the opening and use of an open end credit account or an entire credit contract would be considered a single "transaction" for purposes of this section, the Board said that Congress should clarify this term to preclude its application to each separate extension of credit under an open end credit plan, or to each periodic statement or other single component of a consumer credit contract.

II. A number of the Commission's recommendations are constructive, although they would have to be studied carefully prior to adoption.

Appraisal Fees and Credit Reports

The Commission recommended that Section 106(e) of the Truth in Lending Act be amended to delete as excludable from the finance charge appraisal fees and credit reports.

The Act contains several specific exclusions from the finance charge for fees charged by the creditor in connection with a real property transaction. Among these excluded charges are "appraisal fees" and "credit reports." Such charges are specifically included in the finance charge in non-real property transactions. The Commission suggests that this exclusion be removed so that such fees will uniformly be treated as a portion of the finance charge. The Board supports this recommendation in theory, but notes that the effect of this change on the APR would be so minimal as to raise questions whether it is worth the reprinting of forms and restructuring of disclosure procedures which it would entail.

Oral Disclosures

The Commission recommended that the Truth in Lending Act be amended to provide that the Act and Regulation Z apply to oral disclosures.

A continuing source of problems has been the practice of some creditors of quoting add-on or discount rates in response to consumer requests for information about the cost of credit. Since such rates are approximately one-half the annual percentage rate, their use may severely hamper a consumer's ability to shop for the best credit terms by way of telephone. The Board is sympathetic to this recommendation, and its staff is presently attempting to draft a formal Board interpretation of the Regulation which would discourage the use of any rate other

Reducing Advertising Requirements

The Commission recommends that the items required to be disclosed once full disclosure in an advertisement is "triggered" should be reduced in both closed-end credit and open-end credit.

The Board has seen no indication that the amount of information presently required to be disclosed in closed-end credit is burdensome or discourages meaningful advertising and should be reduced. On the other hand, the Board has outstanding a proposal which would trim back the requirements for open-end credit under Regulation Z. The Commission's proposal selects a few different items for inclusion in an open end credit advertisement, and deletes some which the Board thought important in its proposal. For example, the Board thought that the present statutory requirement that any "free-ride" period be shown is a good one. The Commission would not include this requirement. The Commission would require disclosure of the minimum periodic payment required, whereas the Board's proposal would not.

The Board supports the thrust of the Commission's recommendation that the advertising disclosures in open-end credit (but not closed end credit) be reduced, with the reservation that it would not select the same items for inclusion in such advertisements as would the Commission.

Preemption of State Law

The Commission recommended Federal preemption of State laws which are inconsistent with the Federal Truth in Lending Act or which require disclosures which might tend to confuse the consumer or contradict, obscure, or detract attention from disclosures required by the Truth in Lending Act and Regulation Z.

The Commission notes that some State statutes require disclosures which may be different from the Federal statute and that the two sets of disclosures may be confusing to the consumers. Since one of the unfortunate features of Truth in Lending is the complex nature of the disclosure statement, the Board favors action which would tend to reduce the complexity of the disclosures. It might be noted that the Commission's recommendation is largely reflected in section 111(a) of the existing statute which provides that "This title does not annul, alter, or affect, or exempt any creditor from complying with, the laws of any State relating to the disclosure of information in connection with credit transactions, except to the extent that those laws are inconsistent with the provisions of this title or regulations thereunder and then only to the extent of the inconsistency."

Assignee Liability

The Commission recommended that the Truth in Lending Act be amended as necessary to assure that subsequent assignees are held equally liable with the original creditor when violations of the Truth in Lending Act are evident on the face of the credit agreement or disclosure statement.

While the present language is ambiguous, section 131 of the Act may already place such liability upon an assignee. This section could, however, stand clarification and the Board is inclined to support this recommendation.

Injunctive Relief

The Commission recommended the adoption of legislation to permit private suits seeking injunctive relief for false or misleading advertising.

While the courts, may, themselves, be willing to grant such relief under the present statutory provisions, the clear legislative grant of such authority would assist to enforcement.

Advertising Rates Other Than the APR

The Commission recommended that sections 143 and 144 of the Truth in Lending Act be amended to make clear that there may be no expression of a rate in an advertisement of closed-end credit other than the annual percentage rate as defined in the Truth in Lending Act and Regulation Z.

It appears that the Commission was referring to advertisements of the discount or add-on rate. The use of such rates would specifically be prohibited by the Board's outstanding proposal to amend Regulation Z, and the Board supports the recommendation.

Closing Costs

The Commission has alternatively recommended that a full statement of all closing costs to be incurred be presented to a consumer prior to his making any downpayment or at the time the lender offers a commitment or not later than a reasonable time prior to final closing of a consumer credit real property transaction.

At present, the Act requires disclosures to be made "before the credit is extended." The Regulation attempts to be more specific by requiring that disclosures be made prior to "consummation" of the transaction, which is defined as a time when a contractual relationship arises between the parties. In some real estate transactions, "consummation" may not occur until closing, and it is at that point, for the first time, that the prospective borrower receives his disclosures. It is generally believed that disclosures at closing in such a complicated transaction do not give the consumer an adequate opportunity to use them to assess the terms of the transaction. The Board has outstanding a proposal to require disclosures 10 days prior to closing. While the comments on the proposal indicate that a fixed 10 day period is impractical and burdensome to both creditors and consumers, the Board supports the concept of early disclosure in real estate transactions.

Under the Act, a statement of "closing costs" is not presently required to be given with the Truth in Lending disclosures, unless such charges are financed--i.e., not paid in cash at the time of closing. Thus even if a pre-settlement disclosure rule were adopted under the present statutory scheme, it would still not meet the Commission's concerns. The Board indicated in its Annual Report that in order to be more meaningful to the consumer any disclosure prior to settlement should also include "closing costs" and it supports the concept behind this proposal.

Publication of Statistical Data

The Commission recommended that the Board regularly publish a statistical series showing an average (and possibly a distribution) of annual percentage rates for at least three major types of closed end consumer instalment credit: new automobiles, mobile homes, and personal loans.

The Commission report argues that publication of these interest rate statistics would help consumers to shop more wisely for credit and possibly enhance the role of Truth in Lending as a tool of economic stabilization as consumers observe and react to changing credit costs. Data now published by the Board at the request of the Commission on Interest and Dividends--in the G.10, J.3, and G.11 releases--meet the substance of this recommendation.

III. The Board has questions about several of the Commission's recommendations.

Credit Life Insurance

The Commission recommended that creditors be required to disclose the charge for credit insurance both in dollars and as an annual percentage rate in the same manner as the finance charge is required to be disclosed. Additionally, where credit insurance is advertised, the Commission recommended that the premium be required to be expressed as an annual percentage rate.

While the recommendation is not entirely clear, the Commission is apparently suggesting that a second APR (a function of the amount of coverage, the premium, and the period of coverage) be added to the Truth in Lending disclosures. The Board believes that this recommendation may not be in the consumer's best interest. The Truth in Lending disclosures are already exceedingly complex, and the addition of a new rate would simply further complicate them and would probably detract from the disclosures already being made. Moreover, the purpose for showing an APR is to enable the consumer to use this information to shop for better terms and, since one cannot separately shop for credit insurance, the rationale behind rate computation is not applicable to these insurance premiums.

Under the existing statutory provisions, the dollar cost of the insurance must be disclosed.

Public Utility Exemption

The Commission recommended the repeal of section 104(4) of the Truth in Lending Act which exempts public utility transactions from disclosure requirements.

Section 104(4) of the Truth in Lending Act exempts most public utility bills from its coverage, even though they may provide for a discount for early payment or a charge for a late payment. There has been some question whether such billings should be subject to some form of disclosure, particularly translation of the discount or late charge into an annual percentage rate. A recent study by a committee of the National Association of Regulatory Utility Commissioners recommends that State regulatory commissions "adopt a 'full disclosure' policy regarding utility billing." This policy includes, among other disclosures, the disclosure of an effective annual rate if the bill is not paid when due.

The Board believes that the suggestion of this committee for State-required disclosures may be preferable to simply removing the utility exemption from the Federal Act for two reasons. First, even if utility bills are subject to Truth in Lending, the annual percentage rate would not be required to be disclosed on many of them, by reason of the small transaction exemption. Second, Regulation Z provides that bona fide charges assessed for delinquent payments are not finance charges subject to the disclosure requirements. It appears that the charges imposed by many utility companies would meet the "late payment charge" exemption in the Regulation and therefore would not be considered finance charges subject to annual percentage rate translation. The dollar amount of the lost discount is already shown on utility bills, and little would be gained by simply having it labeled a "finance charge."

Advertising Only the APR in Open-End Credit

The Commission recommended that creditors offering open-end credit be permitted to advertise only the periodic rate and the annual percentage rate.

As presently written, if the annual percentage rate is advertised in open-end credit, this "triggers" the advertising provisions which require that the creditor give additional information about the credit plan in the advertisement. However, the rate may be advertised by itself in closed-end credit advertising.

The Board presently has outstanding a proposal for restructuring the open-end credit advertising section of Regulation Z. In connection with the preparation of this proposal, the staff specifically rejected the change suggested by the Commission. It did so in the belief that while the rate, by itself, is a meaningful term in closed-end credit, it is not meaningful in open-end credit. For example, a variety of creditors may all advertise an 18% APR when there may be vast differences which make one plan much more costly than the other. One creditor may use the "previous balance method" where payments and credits are not taken into account before assessing the finance charge. Another may use the "adjusted balance" method in which all payments and credits are taken into account. Another creditor may have an additional transaction charge which would not be reflected in the rate quoted in an advertisement. The Board questions the wisdom of this recommendation.

More-Than-Four-Instalment Advertising

The Commission recommended that the Truth in Lending Act should be further amended to require creditors who do not seperately identify the finance charge on credit transactions involving more than four instalments to state clearly and conspicuously in an advertisement offering credit: "THE COST OF CREDIT IS INCLUDED IN THE PRICE QUOTED FOR THE GOODS AND SERVICES."

The need for this required Federal language in such advertisements seems highly questionable. Where the creditor advertises his price, the consumer may be concerned as to whether he has been told the full price but it is doubtful that he will care whether the credit charge is presumed to be included in the price or whether no charge for credit is claimed. To him, the price is the price. The Board suggests caution in adopting this recommendation.

Seller's Points

The Commission recommended that the Truth in Lending Act be amended to make clear the presumption that all discounts or points, even when paid by the seller, are passed on to the buyer and hence must be included in the finance charge.

The Truth in Lending Act provides that all charges, including "points" and "discounts" payable directly or indirectly by the borrower and imposed directly or indirectly by the creditor are finance charges. This raises the issue whether points paid by the seller should be disclosed as a portion of the finance charge since they are often paid indirectly by the purchaser as an increase in the purchase price of the house. Seller's points are particularly common in FHA or VA mortgages where by law only one point may be charged directly to the purchaser, and the FHA and VA rate ceilings may be below prevailing market rates. In order to insure an appropriate yield, commonly the seller of the property will be assessed points by the lender.

At present, the Board's position is that if seller's points are, in fact, added to the purchase price and therefore indirectly paid by the borrower, they must be shown as a portion of the finance charge. (See 12 C.F.R. § 226.405). However, if the purchase price is not so inflated (and apparently it not always is) the seller's points need not be shown as part of the finance charge. The problem is knowing whether such points are in fact built into the purchase price of a particular house (although under the Board's interpretation, for convenience, a creditor may presume that all seller's points are indirectly paid by the buyer). This uncertainty has undoubtedly prompted the Commission's recommendation.

Unfortunately, when seller's points are considered part of the finance charge, this results in some very complicated disclosures. On the assumption that simplifying disclosures may be more important than adhering to a theoretically precise postion that all charges--no matter how indirectly imposed--must be included in the finance charge, the Board's staff is reviewing the question whether it might ultimately be more beneficial to take the position that seller's points need not be included in the finance charge. Therefore the Board is not presently prepared to support the Commission's recommendation.

5/14/73