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THE EXPANDING ROLE OF THE FEDERAL RESERVE IN CONSUMER CREDIT

Remarks by

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Over the past several years, the Federal Reserve's role in protecting the interests of consumers in credit transactions has expanded rapidly. The Board's first direct consumer oriented authority came with passage of the Truth in Lending Act in 1968. That Act required the Board to write regulations concerning the uniform disclosure of credit costs while the enforcement responsibility was divided among nine Federal agencies according to the type of institution each regulates. It is, at least partly, the success of the Truth in Lending program which has led Congress recently to grant additional consumer protection responsibilities to the Federal Reserve.

As you may be aware, last October President Ford signed into law amendments to the Consumer Credit Protection Act. One amendment, the Equal Credit Opportunity Act, requires the Board to draft regulations prohibiting discrimination based on sex or marital status in any aspect of a credit transaction. The other amendment, the Fair Credit Billing Act, directs the Board to write regulations specifying how creditors must respond to billing complaints from consumers. In both cases, sole rulewriting authority was given to the Board, and administrative enforcement followed the general pattern of Truth in Lending. Both laws will become effective on October 28, 1975.

Since last fall, the Board has been developing regulations which will implement these two Acts. Rulewriting is a complex process which demands balancing many apparently conflicting interests as well as satisfying the objectives of the Congressional mandate. For example,

while there is no legally protected right to receive credit, nor would one be appropriate in a free enterprise system, a great deal can be done by statute and by regulation to assure that access to credit is made available on a just and fair basis to equally creditworthy people. The denial of credit based upon sex or marital status, rather than upon factors specifically related to an individual's creditworthiness, works to the economic disadvantage of applicants and creditors alike. As for billing complaints, certainly a consumer needs an arrangement whereby a fair opportunity is provided to assure that the amount shown in a billing statement accurately reflects the account.

In the past month, the Board culminated the initial phase of the rulewriting process by issuing for public comment proposed regulations for both the Equal Credit Opportunity Act and the Fair Credit Billing Act. These draft regulations are the tentative set of rules proposed by the Board to augment the statutory framework erected by Congress. I want to discuss these draft regulations and some issues raised by them of interest to those on both sides of a credit transaction.

Equal Credit Opportunity Regulations

During the past few months Board staff has met with representatives of major lenders and trade associations and with representatives of leading women's groups. These meetings outlined in clear detail the kind of difficulties women applicants for credit face and provided information to assess the economic impact of various regulatory alternatives on creditor operations. Even though extensive analysis and careful drafting preceded publication, the proposed regulation is not without potentially controversial aspects.

The use of sex or marital status in a credit-scoring system may become one such area of debate. The statute and the legislative history seem to suggest that sex and marital status are not to be used as determinants of an individual applicant's creditworthiness, even in statistically valid credit-scoring systems. If so, creditors could not assign a value to sex or marital status in a credit-scoring or point-scoring plan. However, the proposed regulation does permit a creditor to inquire about an applicant's marital status if the creditor routinely makes such inquiries in order to ascertain the creditor's rights and remedies applicable to the particular extension of credit.

Of course, the proposed regulation would not prohibit a creditor from relying on factors related to an individual applicant's financial or legal status. Furthermore, although the proposed regulation specifically would require that a creditor consider qualified alimony, child support, or maintenance payments as ordinary income for credit purposes, the creditor would have the right, as in any analysis of credit risk, to use such information as the length of time and regularity with which support payments have been received and the credit history of the payer.

Another aspect of the proposed regulation which would have a significant impact on current creditor practices is the requirement that credit records be maintained in the names of both spouses. Customarily credit records of married individuals are kept in only one name, usually that of the husband. Should a marriage later be dissolved, either by separation, divorce, or death, the woman often encounters significant difficulty in establishing credit under her own name. She

discovers that she has no prior credit history. The proposed requirement would in effect, mean placing the names of both spouses on a credit record, not creating a new duplicate record for existing accounts. Thus, a woman could, in this manner, develop a credit history should one ever become necessary. To mitigate somewhat the immediate operational impact of this requirement, creditors would be given twelve months in which to accomplish the change-over in recordkeeping procedures.

The proposed regulation also states that whenever a creditor has denied or terminated credit to an applicant, that applicant, upon request, must be furnished a meaningful written statement supporting the reason for denial or termination. Since the Equal Credit Opportunity Act is essentially a self-enforcing statute, applicants must have access to the information necessary to evaluate a creditor's decision and, where appropriate, assert whatever rights and remedies are provided under the Act.

In discussions with various creditor groups, some creditors have disclosed a reluctance to provide applicants with the reasons for denial of credit. This attitude is predicated upon the assumed difficulty of explaining the reasons for denial under scoring systems where rejections are based on a number of weighted criteria rather than on any one individual factor. However, I might point out that under the existing standards of the Fair Credit Reporting Act, creditors are already required to send notice of a denial of credit if the denial was based on adverse credit reports or information obtained from a third party. To extend current reporting requirements by requiring that credit denials be more specific does not appear to be unduly burdensome to creditors.

With regard to these regulations, the Board intends to give serious consideration to all written comments received, whether they are from creditors or consumers. Also, informal hearings have been scheduled beginning May 28, 1975, and anyone who wishes to present oral comments during that time should contact the Secretary of the Board in writing by May 14 to make arrangements for an appearance.

Fair Credit Billing Regulations

Earlier in my remarks I referred to the Fair Credit Billing Act, which will become effective on October 28, 1975. Proposed regulations implementing the Act have just been published in the Federal Register, and the public has been invited to submit comments in the next 30 days.

Since the Fair Credit Billing Act amends the Truth-in-Lending Act, the implementing regulations have been incorporated, for the most part, in the existing sections of Regulation Z, with the addition of one new section that sets out the billing error resolution procedure. The proposed regulations attempt to clarify those areas of the law which remain unclear as well as to supplement its requirements with technical instructions for compliance.

One major clarification in the regulation relates to the scope of the Act. After enactment, there was some question as to whether the billing error resolution procedure would be available to consumers with instalment loans and other types of closed-end credit as it is to

customers with credit card or revolving charge accounts. The regulation specifies that only closed-end credit extended by use of a credit card is subject to the requirements of Fair Credit Billing. All other closed-end credit is specifically excluded.

Another important issue that has arisen involves customer complaints concerning the quality of merchandise and whether such complaints should be included in the definition of a billing error. The regulation permits consumers to base their billing error complaints on their rejection of merchandise as not conforming, where that rejection was done in conformance with the requirements of the Uniform Commercial Code, which specifies what constitutes acceptance or rejection of goods.

The actual billing error procedure section of the regulation clarifies a problem not addressed by the Act as to the computation of minimum payments and finance charges on disputed amounts, especially when the dispute is later resolved in the creditor's favor. The regulation provides that the creditor may require any missed minimum payments to be made up. In addition, the creditor may impose accrued finance charges on the amounts owed prior to the creditor's receipt of the customer's notice of a billing error; however, a creditor may impose no finance charges on disputed amounts during the time the billing error resolution procedure is taking place. Following resolution, the creditor is required to send the customer a statement of the amount owed at least 14 days prior to the imposition of any additional finance charges.

With regard to these and any other issues, the Board will welcome and give serious consideration to any comments received during the period provided for public comment prior to final adoption of the regulation.

F.T.C. Improvements Act

In addition to the two Acts I just discussed, on January 4, 1975, President Ford signed the Federal Trade Commission Improvements Act, which considerably expanded the responsibilities of the Federal Reserve in the area of saver and consumer affairs. Under the FTC Improvements Act banks must now comply with rules respecting unfair and deceptive practices as developed by the Board. These regulations may affect both consumer and commercial banking activities and, in this connection, the Board may issue regulations on its own initiative. The statute also requires the Board to issue regulations that are substantially similar to those issued by the FTC, unless the Board finds that such acts or practices are not unfair or deceptive as practiced by banks or that such regulations would seriously conflinct with essential monetary and payments systems policies.

On April 24 the Board published for comment a regulation substantially similar to the Federal Trade Commission's proposed Unfair Credit Practices Rule which prohibits the use of certain collection practices and conditions commonly found in credit contracts considered unfair by the Commission. The proposed rule would also require specific disclosures to co-signers to inform them of the legal ramification of the agreements which they sign. General comments on the rule as well as any specific comments directed to reasons why the Board should not ultimately adopt and apply the proposed rule to banks, should be submitted to the Board during the comment period which ends June 10.

Clearly, the F.T.C. Improvements Act will broaden the Board's consumer protection activities. It bears reemphasis, then, that the Board has been granted innovative as well as reactive responsibility. As an indication of the more active consumer role of the Federal Reserve Board, the Board created a new Office of Saver and Consumer Affairs last August. This Office was charged with the responsibility of assuring that the interests of savers and consumers are given adequate and specific attention in Board decisions. Since general oversight of the Board's Truth in Lending activities had already been assigned to me, I was also given responsibility for the expanded activities of the new Office. The Office of Saver and Consumer Affairs is now almost fully staffed and is actively engaged in the conduct of its many new legislative responsibilities. While primary emphasis has, of necessity, been placed on the drafting of Equal Credit Opportunity and Fair Credit Billing regulations, I look to the staff of OSCA--as the office is called--to take the initiative in proposing innovative consumer programs for the Board.

Conclusion

In concluding, let me ponder for a moment the political background against which decisions concerning a possible expansion of consumer activity for the Federal Reserve may be reached. As you

know, 1975 has already seen a number of key changes both in the composition of the Congress itself and in the Chairmanship of several major committees. Senator Proxmire, present Chairman of the Senate Committee on Banking, Currency and Housing, has a well known record of consumer interest. In 1972, he served as a member of the National Commission on Consumer Finance. Certainly, he can be expected to promote a high degree of concern for the consumer in deliberations on new legislation.

Chairman Reuss of the House Committee on Banking, Currency and Housing, in accepting the chairmanship, announced his intent to pursue a vigorous policy of legislative oversight.

Certainly, we are rapidly entering an age of consumer protection. Since the passage of Truth in Lending in 1968, consumer-oriented legislation has increased both in quantity and scope. Given the current composition of the Congress, it is only reasonable to expect that additional consumer legislation will be enacted well before the end of 1975. What that probably means for the Federal Reserve is continued expansion of its role in the area of consumer credit. For the banking industry, it may require changes in customary business practices. While such changes may appear to some, at first glance, to be disruptive and costly, they may also provide the impetus for economic growth and innovation in meeting the real needs of the consumer public.

As 1975 progresses, I would hope that the interests of consumers, the credit industry, the Federal Reserve and the Congress can be successfully merged in forging a new era of equality, fairness and opportunity in the dispensing of consumer credit to all creditworthy individuals.