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Statement by

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before the

Subcommittee on Consumer Affairs and Coinage

of the

Committee on Banking, Finance and Urban Affairs

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I appreciate the opportunity to appear before this subcommittee on behalf of the Board of Governors of the Federal Reserve System to comment on the credit and charge card legislation being considered in H.R. 2440 as well as other issues concerning credit cards.

H.R. 2440

H.R. 2440 would amend the Truth in Lending Act to provide for additional disclosures to accompany credit and charge card applications and pre-approved solicitations mailed to consumers. The bill would also expand the Truth in Lending Act disclosure requirements for credit and charge card advertisements. Finally, the bill would require additional disclosures, and provide substantive rights to consumers, in connection with certain changes in the terms of card accounts.

The Board believes that existing law generally provides adequate disclosure to consumers of the key costs associated with credit and charge card accounts. Furthermore, there is a wealth of public information available to consumers about credit card rates and non-rate terms. For example, the Federal Reserve Board collects information and then publishes a semi-annual report of the terms of credit card plans offered by the largest card issuers in the country. The Board's September 1991 report, which is attached to this statement, includes 28 card issuers that offer a rate below 16 percent. Seventeen issuers impose no annual membership fee. Lists of rates and other fees offered by card issuers also are available from groups such as Bankcard Holders of America and from commercial sources. In addition, the media report on credit card rates. In short, it is not apparent to the Board that the current disclosure rules and

public information on credit card charges need to be supplemented by further legislation.

Disclosures on card applications and solicitations

In March 1989, the Fair Credit and Charge Card Disclosure Act amendments to the Truth in Lending law went into effect. Prior to these amendments, consumers sometimes did not receive full disclosure of the credit terms on their card accounts until after they received a credit card accessing the account.

The Fair Credit and Charge Card Disclosure Act requires card issuers to provide early disclosure of rate and other cost information to potential cardholders. The disclosures generally must be provided in direct mail or telephone applications and pre-approved solicitations and in applications made available to the general public. Most of the required disclosures must be provided in the form of a table prescribed by the Board, which allows easy comparison of the terms offered by different card issuers. A sample of this table is attached.

H.R. 2440 would require that the prescribed disclosure table appear on envelopes containing card applications or pre-approved solicitations mailed to consumers. For card issuers that operate in several states, providing their disclosure tables on the outside of envelopes could be difficult given the length of the disclosures.

While the Board recognizes the value of early disclosure of essential credit information to consumers to facilitate credit shopping, it believes that this proposed requirement would not offer any meaningful benefit to consumers. The consumer who is intrigued by a card issuer's offer to open an account will of necessity have to open

the envelope in order to act on the offer, and therefore will encounter the current disclosure table. The consumer who fails to open the envelope (and thereby doesn't see the disclosure table) obviously is not taking the offer, hasn't been misled by the card issuer's marketing, and cannot be deemed to have been harmed just because the table isn't on the outside of the envelope. Accordingly, the Board believes that this additional disclosure requirement is unnecessary.

Credit card advertising

The Truth in Lending Act currently provides that if creditors mention specific costs in advertisements for any type of open-end credit product, other relevant cost information must also be disclosed. Under this "trigger term" approach, if a card issuer advertises its annual percentage rate, for example, it must also disclose any minimum finance charge, transaction fee, or similar charge. The Board by regulation also requires that any membership or participation fee be disclosed.

In general credit card advertisements, where no specific costs are stated, the law does not mandate that any other cost information be provided. In addition, if creditors advertise that certain fees are not charged on an account, no additional disclosures are required. For example, a card issuer may advertise that no annual fee is imposed on a card account without disclosing the rate. Or a card issuer may represent in an advertisement that the annual percentage rate on its accounts is "low, without providing additional disclosure. Consequently, while the Truth in Lending Act, and the Board's implementing regulation, generally require uniform disclosure of cost information in credit advertisements, they do not require full cost information

about credit and charge cards in all advertisements, only those in which the advertiser "triggers" the need for further detail.

H.R. 2440 would expand the Truth in Lending Act advertising provisions to specifically mandate detailed disclosure in any advertisement that promotes credit and charge card accounts. The bill would require that the prescribed Fair Credit and Charge Card Disclosure Act table as well as information about cash advance fees be included, or referred to, in all advertisements of card accounts no matter how brief or general. There would be different disclosure requirements depending upon the medium in which the card advertisement is promoted (such as television, radio, or print).

The Board understands the apparent concern behind this provision of the proposed legislation -- that consumers may not be getting full disclosure of credit terms in general advertisements. Nevertheless, the Board believes Congress should not mandate that cost information be included in all advertisements. Mandated disclosures in advertisements could lead to a decrease in advertising as opposed to an increase in disclosure. The costs of compliance as well as the possible length and complexity of the proposed disclosure requirements -- inclusion of a disclosure table in any form of advertising -- could cause some card issuers to cut back on advertising.

The Board believes that the current disclosure scheme under the Truth in Lending Act gives consumers ample opportunity to ascertain and review account terms prior to being obligated on a card account. The advertising rules provide for the uniform disclosure of credit terms where specific cost information is mentioned. The

Fair Credit and Charge Card Disclosure Act requires disclosure of key terms in those situations where card issuers are aggressively marketing their card accounts, for example, in direct mail or telephone campaigns. In addition, the Truth in Lending Act has always required that consumers be provided with full disclosure prior to their becoming obligated on open-end plans. Moreover, the Board by regulation has provided that if full disclosure is not given beforehand, a consumer may reject the plan once disclosures are received and the creditor must refund any membership fee already paid.

If Congress, nonetheless, decides to go forward with legislation to amend the open-end advertising rules, the Board urges Congress to retain the "trigger" concept of advertising, perhaps adopting the approach used in the Home Equity Loan Consumer Protection Act of 1988. That law provides that both affirmative and negative references to "trigger" terms in advertisements would require additional Truth in Lending disclosure. Under such a rule, advertising "no annual fee" or "no transaction charge" would call for further disclosure. The Board believes this more limited approach would effectively address most of the congressional concerns about credit card advertising. In general, however, we do not believe there is a compelling enough need to amend the law at this time.

Changes in the terms of a card account

Currently, creditors are required to provide consumers with advance notice of changes in rates and other key cost terms initially required to be disclosed under the Truth in Lending Act. The notice must be provided at least 15 days before a change

takes effect. The act itself does not require this notification. The change in terms requirement, which the Board established by regulation, has been in effect since 1969.

H.R. 2440 would provide a statutory change in terms notice requirement. The proposed legislation would require 30-day advance notice of any adverse change in the items that appear in the disclosure table required under the Fair Credit and Charge Card Disclosure Act as well as any increase in a cash advance fee. The proposed legislation would also require that the notice of change, along with the entire disclosure table, be provided prior to the change on one or more periodic statements of account activity sent to consumers.

The Board does not believe there is a need for this additional disclosure requirement. We have little evidence that consumers are inadequately informed about changes in the terms of their accounts such that additional disclosure is merited. Rather, consumer concern is likely based on the fact of a change taking place, not the lack of advance knowledge of the change. This is borne out somewhat by the consumer complaints received by the Board in this area, albeit they are few in number. Furthermore, if the legislation became law, there would be two different time periods for change in terms notification -- 15 days and 30 days -- depending on whether or not the open-end plan had a card associated with it. This seems unnecessarily complicated.

H.R. 2440 would also provide a substantive right to cardholders, permitting them to cancel an account and pay off any outstanding balance under existing terms when certain changes in terms occur (for example, an annual percentage rate increase).

Although the Truth in Lending Act includes some substantive provisions, it remains primarily a disclosure statute. The Board continues to believe that substantive laws should generally be left to the realm of state law. Some states have in fact legislated in this area, although it should be noted that only about half a dozen states have seen the need to give cardholders the right to pay off existing balances on the terms in effect at the time of change. If Congress nonetheless decides to adopt this opt-out provision, it should at least limit the time period for consumers to pay back the outstanding amounts owed.

While the proposed legislation seeks to protect consumers, there may be adverse consequences for consumers themselves. Faced with a federal law that essentially restricts their ability to change the terms on accounts, card issuers may tighten the availability of credit or they may adjust the pricing on card accounts, making the use of credit cards more expensive. Issuers might, for example, stiffen the penalty for late payments or exceeding a credit limit. Some might charge fees that typically have not been imposed, such as application processing fees or transaction fees for purchases. Some might eliminate or shorten grace periods. These actions could have a negative effect on consumers generally and on less affluent borrowers in particular. Furthermore, restricting card issuers' ability to change terms would not provide much of an incentive for issuers to reduce credit card interest rates when conditions might permit reductions; if rates were lowered, it would then be more difficult for card issuers to increase them when necessary.

In summary, the Board does not believe that new disclosure or substantive requirements are needed in connection with credit and charge card accounts.

THE CREDIT CARD INDUSTRY

The Fair Credit and Charge Card Disclosure Act directs the Federal Reserve to report to Congress annually about the profitability of credit card operations of depository institutions. The Board has issued two reports, one in 1990 and another last month. The 1990 report showed that in recent years credit card profitability generally was higher than returns on other major bank product lines. The 1991 report found that net earnings of credit card banks were higher in 1990 than in both 1989 and 1988.

Competition among card issuers is intense and has taken several forms. For example, some card issuers are lowering or waiving fees such as annual membership fees, raising credit limits available to customers, offering program enhancements such as purchase protection plans and travel insurance, or offering rebate programs for purchases or discounts on various services. These changes have effectively reduced the costs many consumers incur, or increased the benefits many consumers enjoy, in holding and using their credit cards.

Although some industry consolidation has occurred recently, new firms continue to enter the market and existing firms continue to expand operations. Over the past few years, there has been an increase in the availability of credit cards to consumers. Several major new card issuers have entered the market. One, Greenwood Trust,

which issues the Discover Card, is now the largest card issuer in the country. A second, Universal Bank, which issues the AT&T Universal card, has attracted some eight million cardholders in less than one year. Further entry into the market by large businesses is anticipated as evidenced by the announcement of major U.S. automobile companies and at least one large regional telephone company of their intention to offer credit cards.

At the same time, there have been recent increases in problem loans. Credit card delinquency rates and consumer bankruptcies, which directly relate to credit card losses, have risen substantially. In 1990, over 717,000 nonbusiness bankruptcies were filed, compared to 616,000 in 1989, and just over 284,000 in 1984. For bank credit cards, in 1984, 3.3 percent of outstanding debt was 30 or more days delinquent. That figure has increased and by the end of 1990, 4.46 percent of outstanding bank credit card debt was delinquent. In spite of this, credit card operations continue to be a strong performing segment of the banking industry.

Lack of change in credit card interest rates

A notable phenomenon in the card market is that interest rates on credit card debt have remained quite stable in recent years. We, of course, are aware of the long-standing concerns of some about the sustained high level and rigidity of credit card interest rates.

As with other types of credit, the cost of funds for credit card operations is an important component of average and marginal costs, although it is substantially less important for credit card operations than it is for other major types of bank lending.

On average, credit card rates have not responded significantly to changes in funding costs. In analyzing the reasons for this, it is important to bear in mind that the interest rate is only one element of credit card pricing. Other features, such as annual fees, grace periods, late payment fees, and enhancements, are also important components of overall pricing. Card issuers may choose to modify these elements, rather than lending rates, when costs of funds change. Issuers may also choose to relax credit requirements or raise credit limits, in order to broaden and maintain their customer base. Or, of course, they may simply benefit from the public's willingness to continue to borrow on their credit cards even when the interest rates charged do not respond to a decline in card issuers' costs of funds.

There is a debate about why credit card interest rates seem to be so stable. One possible explanation of price "stickiness" relates to the differences in consumer behavior or the type of consumer that card issuers encounter as a result of rate increases or decreases. There is a presumption under this theory that card issuers face at least two classes of consumers whose behavior makes rate reductions unattractive even when funding costs decline. The first class of consumers do not intend to borrow on their accounts, but instead, maintain credit card accounts primarily for convenience. While these convenience users may unexpectedly borrow at high rates, their use of credit is not responsive to changes in interest rates. They are valuable customers for the bank since they may be better credit risks and are unlikely to respond to interest rate changes. The second class of consumers fully intend to borrow

on their credit card accounts, and are therefore more responsive to rate changes. These consumers may, however, be less attractive credit risks.

Since a reduction in rates will attract few of the more creditworthy consumers but perhaps many that could cause losses from delinquency or default, this theory proposes that issuers faced with these results will be reluctant to reduce rates in response to reductions in funding costs. I should add that this theory is somewhat controversial, since it assumes persistent irrational behavior on the part of a class of consumers.

An alternative explanation offered for the stickiness in rates assumes that established credit card issuers have a solid customer base that does not change its use of credit cards in response to changes in interest rates, due to the costs of searching for and switching to another card provider. These costs include: (1) the time and effort to identify a more attractive credit card and to complete a new credit card application; (2) the potential effect of having a credit rejection added to a credit bureau report; (3) the possibility of a reduced credit limit with the new issuer; (4) uncertainty about the quality of service with a new card issuer; and (5) uncertainty about future rates and fees. It may also be true that the potential savings in interest costs from switching from a high-rate issuer to a low-rate issuer are not substantial. Since the average balance outstanding for those who regularly borrow is approximately $1500, a reduction in credit card rates from, for example, 20 percent to 16 percent is likely to save the consumer about $60 a year. I suspect that for many consumers this potential

savings is not sufficiently great to overcome the convenience of retaining their current accounts and the costs of changing accounts.

If credit card issuers perceive that the demand for their credit cards is not very sensitive to interest rates, they may have little incentive to adjust them rapidly to changing financial conditions. This is particularly true if, in addition, they must incur some costs to change credit card rates (such as costs to advertise, change solicitation literature, and generally inform customers of changes). The gain from changing prices simply may not justify the cost of doing so for those card issuers.

Although these and other explanations have been offered for the marked stickiness in credit card interest rates, little consensus exists as to which explanation has the most merit.

In closing, I would like to emphasize that the Board believes it is important for consumers to have adequate information to shop for credit. But more disclosure is not necessarily better disclosure. The federal law requiring early disclosure of credit card terms has only been in effect for about two and a half years. The full effect of this law should be realized before additional federal legislation in the credit card area is adopted. Moreover, compliance with ever-changing laws and regulations imposes substantial costs on creditors. We believe these costs will ultimately be borne by consumers through increased prices or reduced services.

Sample Credit Card Disclosure Table

ANNUAL PERCENTAGE RATE FOR PURCHASES	VARIABLE RATE INFORMATION	GRACE PERIOD FOR REPAYING PURCHASE BALANCE	METHOD OF COMPUTING THE BALANCE FOR PURCHASES	ANNUAL FEES	MINIMUM FINANCE CHARGE	TRANSACTION FEE FOR PURCHASES
____%	Your APR may vary. The rate is equal to the _____ index plus ____%.	____ Days	Average Daily Balance Method (excluding new purchases)	$____ Annual Membership Fee	None	None

Transaction fee for cash advances: ____% or $ ____, whichever is greater

Late payment fee: $ ____

Over-the-credit-limit-fee: $ ____