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Statement by

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before the

Subcommittee on Financial Institutions and Consumer Affairs

of the

Committee on Banking, Housing, and Urban Affairs

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I appreciate the opportunity to appear before this subcommittee to discuss the disclosure requirements of three bills dealing with credit card applications and solicitations: S. 2140, S. 2264, and S. 2421. All three bills would add an early disclosure requirement to the Truth in Lending Act for open-end credit card plans. S. 2421 is narrower than the other bills in that it deals only with disclosures in mail solicitations, though it also addresses the balance computation methods used by certain credit card issuers. S. 2264 would also require credit card issuers to report certain cost terms to the Board, and would require the Board in turn to make this information available to the public and to report it annually to the Congress.

Currently, the law requires early disclosures only when creditors engage in advertising. Solicitations for credit are thus subject to some Truth in Lending disclosure requirements, since they are considered "advertisements" under the statute and the Board's implementing regulation, Regulation Z. Whenever certain credit terms are stated in an advertisement, the creditor must give additional information about the credit plan. For example, if the creditor advertises the plan's annual fee, the advertisement must state the annual percentage rate, as well as any other finance charges that may be imposed.

If none of the specified credit terms is stated in the solicitation, however, the law does not require that cost information about the plan be given. Consequently, while the act does at times require that consumers receive cost information with solicitations, the present law does not always require that consumers are given this information before they receive a credit card.

Under the current law consumers must, however, be given full disclosure of the terms and conditions of the credit card program no later than the time that they receive the card. Therefore, consumers do have an opportunity to review all of the the terms and conditions before using the account. In addition, the regulation provides that a consumer may not be obligated on a credit program prior to receiving complete disclosures; this would include, for example, the obligation to pay an annual membership fee.

The proposed bills go beyond the present act by requiring the creditor to include certain Truth in Lending disclosures in any application or solicitation for a credit card plan, without regard to whether the creditor mentions a particular term. The proposed legislation expands the current statutory requirements for advertising in another way as well. The card issuer would be required to disclose the conditions under which a finance charge may be imposed, including whether or not any time period exists for credit to be repaid without incurring a finance charge; in addition, S. 2140 would require disclosure of the balance computation method.

The issue of how much disclosure to require in advertisements has been considered before by the Congress -- most recently in 1980 when it simplified the Truth in Lending Act. At that time, the Congress cut back on the disclosures required in open-end credit advertisements in the hope that reducing the disclosure burden would promote more advertising, thereby increasing competition. To the extent that the proposed disclosure requirements might discourage open-end credit advertisements, this legislation could have the unintended effect of decreasing rather than increasing competition. We are inclined to think, however, that given the limited scope of the increased disclosure in

S. 2421 it would not have that effect. Our impression is that many card issuers are already including in their mail solicitations much of the disclosure information proposed in the bill, and, presumably, have not viewed this as an impediment to advertising. Requiring disclosure in all applications whether or not the application is part of a mail solicitation -- as the two other bills do -- might have the adverse effect which the Congress sought to avoid in 1980.

Increased disclosure requirements invariably result in some increased costs to the industry. Additional costs resulting from S. 2421 would probably not be substantial, given that it focuses on the narrow area of mail solicitations. In mail solicitations creditors should be able to include current disclosure information without significant burden, since such solicitations are usually offered for a limited time with stated expiration dates. Broader legislation, as suggested by S. 2140 and S. 2264, that would require disclosures in all applications for open-end credit cards -- not just in mail solicitations -- could prove to be operationally difficult for card issuers and could result in costs that exceed consumer benefits. For example, card issuers would have to reprint credit card applications when the terms of their credit card plans change. The burden would vary depending on the creditor, however. National banks offering their credit cards nationwide, for example, may be able to have uniform credit terms so that a single solicitation or application would apply to all prospective cardholders. Retailers, in contrast, are generally subject to individual state laws, which would make the use of uniform nationwide documents more difficult. In addition, the burdens associated with additional disclosure requirements would probably be greater for small institutions.

The Truth in Lending Act and Regulation Z mandate that creditors disclose which balance computation method they intend to use -- and provide an

explanation of how that method works. The creditor must provide this information in its initial disclosure statement and must repeat it on each monthly bill.

S. 2421 would also require nonretailer card issuers, such as banks, to use one particular method -- the average daily balance method -- in calculating the finance charge, or an alternative method that results in a lower finance charge.

In general, the Truth in Lending Act does not involve the substantive regulation of credit terms, such as the rate of interest that can be imposed or the types of charges that are permissible. Rather, the focus of the act is on ensuring that consumers receive the most important credit information before becoming obligated. By venturing into the substantive regulation of credit terms via the Truth in Lending Act, the provisions of S. 2421 dealing with balance computations would be a departure from the current approach.

Over the years creditors have used various balance calculation methods for their open-end credit plans, some of which generally produce higher monthly finance charges than others. The "previous balance" method will often result in higher finance charges for consumers, for example. However, the timing of a customer's purchases and payments can influence which balance computation method results in the lowest finance charge. In addition, even within a single balance computation method, such as the average daily balance method, there are variations in how favorable or unfavorable one creditor's method may be to the consumer as compared to another creditor's.

Many of the other terms required to be disclosed, such as the annual fee or the annual percentage rate, are straightforward and easy for consumers to understand. The way the creditor figures the balance to which it will apply the annual percentage rate, however, is not so easily understandable -- even

with the disclosures required by the act and the regulation. Consequently, while a creditor might satisfy the Truth in Lending requirement by explaining how it calculates the customer's balance, the customer may not be able to fully appreciate how one creditor's method differs from another -- and, consequently, how the difference might affect the amount of the finance charge.

One approach to this problem is the one taken by S. 2421: that is, to prohibit all balance computation methods except one. The purpose of such an action, presumably, would be to standardize that feature of credit card programs, so that consumers no longer would have to consider this particular term when comparing credit card programs.

While S. 2421's approach to balance computation may have some appeal, it may affect both the operations and yields of some creditors. If adoption of this approach results in increased operational costs or reduced revenue, the issuer is likely to pass such costs on to its customers in some way or another. Thus, regulating the balance computation method area might result in restricted credit availability, the elimination of grace periods, or higher interest rates, annual fees or merchant discounts. It is uncertain, therefore, whether the benefit of having a uniform balance computation method would exceed the associated costs to consumers after such adjustments have taken place.

And we have more fundamental problems with this aspect of S. 2421. Traditionally, balance computation methods -- like other yield-producing terms, such as interest rates, the amount of transaction charges, late charges, etc. -- have been regulated by the states. In fact, over the years many states have specified the permissible balance methods as one aspect of their overall rate regulation. Because the states consider all determinants of the cost of credit in fashioning their regulations, they probably are in a better position

to regulate the balance computation method in relationship to other credit terms. Moreover, federal legislation of the balance computation method could be viewed as the beginning of federal control of a host of other terms -- such as rebate methods and delinquency charges -- that have long been controlled by the states. Rate regulation has been an important state function and we suggest great caution in overturning this tradition, particularly on a piecemeal basis.

An alternate approach to the problem is to seek increased consumer awareness of balance computation methods. One way of doing this involves educational efforts on the part of industry and consumer groups. A pamphlet dealing with how to shop for a credit card, for example, was just released by the American Institute of Certified Public Accountants in cooperation with the U. S. Office of Consumer Affairs, and we expect it will receive wide distribution. As another example, the Federal Reserve prepares educational materials and conducts presentations for teachers and other groups regarding consumer credit, including credit cards. The Federal Reserve Bank of Minneapolis has developed instructional materials for secondary school teachers, and is currently preparing additional material dealing with credit cards, including balance computation methods. These and other educational efforts should help alert consumers to the fact that differences in credit programs do exist and that "shopping around" may save them money.

S. 2264 would require each credit card issuer to report to the Board on a quarterly basis the average annual percentage rate and any annual or other fee applicable during the preceding quarter. While this idea may seem appealing on initial examination, there are a number of questions about its usefulness and cost that need to be considered. The Federal Reserve is currently analyzing

the results of a study conducted at the request of the Congress to measure the benefits of providing consumers with comparative cost information about closed-end credit. While this demonstration project did not address credit cards, its findings should provide a means of better evaluating the use that consumers make of published lists of comparative rate data. In view of the costs associated with the collection and dissemination of comprehensive information about rates and fees from thousands of credit card issuers, the Board suggests postponing action in this area until the results of the demonstration project are available.

In conclusion, Mr. Chairman, the Board believes in full disclosure -- both because it is the fair way to deal with consumers and because it aids the competitive process. However, given the extensive disclosures already required by Truth in Lending Act when the consumer receives the credit card, and the fact that many card issuers already supply much of the proposed information in their solicitations, we are not sure that legislation is needed. I might add that our files do not show any consumer complaints on the matter. On the other hand, we believe that the burden of the disclosure provisions contained in S. 2421 would not be substantial. In contrast, we believe the scope of S. 2140 and S. 2264 is too broad, particularly in that the bills require disclosures in all applications.

With regard to S. 2421, we appreciate the difficulties that some consumers may have in comparing balance computation methods. However, because these methods have been a matter of state law for so long, and because they are so intimately tied to other state provisions, we do not favor this portion of S. 2421. In addition, the provision in S. 2264 for reporting credit cost

terms to the Board is potentially costly, and until the Board completes its analysis of the demonstration project on closed-end credit rates, we cannot be sure about the extent of the benefits of such compilations.