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Statement of J. L. Robertson, Vice Chairman

Board of Governors of the Federal Reserve System

before the

Subcommittee on Consumer Affairs

of the

Committee on Banking and Currency

House of Representatives

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I appreciate this opportunity to review with the Subcommittee on Consumer Affairs the steps that have been taken to get ready for Z-Day. Since the reference to Z-Day may possibly be puzzling to some of those in this hearing room, let me explain that I am talking about this coming July 1st, the effective date of Regulation Z, prescribed by the Board of Governors of the Federal Reserve System to implement the Truth in Lending Act. And in case these remarks should reach people who have never heard of the Truth in Lending Act, it may be useful to summarize what the Act and the regulation do. Together they spell out the disclosures--chiefly the finance charge and the annual percentage rate--that those who extend consumer credit must make to their customers; they set standards for advertising credit terms; and they permit a customer to cancel some types of credit arrangements within three business days if his residence is used as collateral. This hearing should prove useful in calling public attention to the fact that Z-Day is coming.

At the Board, preparation for this event began before the Consumer Credit Protection Act was signed into law. In February, 1968, we established a task force on Truth in Lending, drawn from the staffs of the Board and the Reserve Banks, aided by outside consultants with experience in various aspects of consumer credit. We wanted to get a head start, since we realized time would be needed not only to study the legislation and then draft and redraft the regulation, but also to issue it far enough in advance of the

July 1st effective date to give creditors time to get ready. Obviously they need time to prepare and "debug" necessary forms, computer programs, and other compliance procedures and to train personnel. And we were determined to do our best to develop a practical, workable regulation--one that would carry out the objectives of the Act without imposing unnecessary burdens on business that could result in higher costs being passed on to the consumer.

In this effort we were most fortunate to have the assistance of the Advisory Committee on Truth in Lending, established under section 110 of the Act. This twenty-member group was appointed by the Board in August; their names and affiliations are given in the attached list. Dr. Richard H. Holton, Dean of the School of Business Administration at the University of California, Berkeley, is chairman of the Committee. Its members were carefully selected to provide a broad representation of retailer, lender, and consumer groups in all sections of the country.

The Advisory Committee has acted as liaison between the Board and the public, including industry as well as consumer interests, with regard to the purpose, scope and implementation of Regulation Z. The Committee has served as an important vehicle for channeling to us advice on problems and issues involved in the preparation of the regulation. The members of the Committee, although selected from the various industry and consumer groups interested in and affected

by the Act, have represented the public in a broad sense, rather than merely their own special interest groups. In short, this has been an effective working committee which has contributed greatly to the development of Regulation Z and will contribute in the future to our informational program and to appraising the effectiveness of Truth in Lending.

The first meeting of the Advisory Committee was held on September 12 and 13, 1968, to review a preliminary working draft of the regulation, which, after redrafting, was released for comment in mid-October.

This draft generated more than 1200 comments and suggestions by industry, consumer groups and others. We also received comments from the other Federal agencies involved in the enforcement of the Truth in Lending Act and were contacted by several State authorities regarding their own consumer credit disclosure statutes. We met again with the Advisory Committee on December 12 and 13 to discuss the major issues presented. All of the comments and suggestions were carefully reviewed and considered in the preparation of the final version of Regulation Z which was made public by the Board on February 10 and printed in the Federal Register on February 11, 1969.

The final version of Regulation Z has benefited substantially from the widespread review that was given to the preliminary version, although there were no changes in the basic disclosure requirements which are, indeed, largely dictated by the law itself.

One troublesome question we faced in this process relates to conflicts between the Federal statute and State laws. Very few States have a truth in lending act, but many States have statutes that require that some types of consumer credit contracts disclose information in a manner that is inconsistent with the Federal statute, either in form of presentation or in method of determining the information. Section 111 of the Federal statute provides that it shall not exempt any creditor from complying with any State law relating to disclosure of information in connection with credit transactions, except to the extent the State law is inconsistent with the Federal law.

Accordingly, section 226.6(b) of the Regulation provides that State law is inconsistent with the Federal law and regulation to the extent that it

(1) requires a creditor to make disclosures different from the requirements of Regulation Z with respect to form, content, terminology, or time of delivery;

(2) requires disclosure of the amount of the finance charge determined in any manner other than that prescribed in Regulation Z; or

(3) requires disclosure of the annual percentage rate determined in any manner other than that prescribed in Regulation Z.

Many of these State laws are not purely "disclosure" statutes; that is, they establish certain requirements that must be met it the credit contract is to be enforceable. For example, some State laws prescribe that an installment sales contract on an automobile, to be valid, must state the cash price and the "time price differential." The "time price differential" must include part--but not necessarily all--of the amounts that must be included in the "finance charge" to be disclosed under the Federal statute. This requirement is inconsistent with the Federal regulations.

Nevertheless, we recognize that there will be cases in which the question of whether a requirement of State law is invalidated by the Federal law will not be entirely free from doubt. Doubts on this score could confront creditors with a hard choice. If they elect to ignore a requirement of the State law, in the belief that it is no longer in force, they run some risk that courts might later determine that the State requirement is still in effect. In such a situation, the creditor might have no valid contract, and could be left without any security to protect his interest, since the failure to comply with the State law might also invalidate the underlying contract and the means of enforcing it.

Creditors as well as consumers urged the Board to minimize the need for dual disclosure, and we have tried to do so in the Regulation.

Since virtually everyone agrees that conflicting disclosures are undesirable, we have good reason to hope that the problem is a temporary one that will disappear as uncertainties regarding the areas of conflict are eliminated.

In the meantime, however, the regulation permits a creditor to make a disclosure specified in State law that is inconsistent with the regulation, if he does so separately and apart from the disclosures required by the regulation, so as not to confuse the borrower by mixing the two. The disclosure may be made on a separate piece of paper, or (if it is clearly marked as being inconsistent with the Federal requirements) on the same piece of paper but below the Federal disclosures. I hope that in time it will be possible to eliminate these provisions for conflicting disclosures, as the problem disappears.

Another (less troublesome) problem involves credit extended "without charge." The Act defines creditors as persons who "regularly extend or arrange for the extension of credit for which the payment of a finance charge is required." In many cases creditors claim to make no finance charge, although in every other respect they regularly extend consumer credit. Take, for example, the merchant who advertises watches for a dollar down, and a dollar a week, with no indication of how many dollars are required to pay for the watch. There is little doubt that he is in fact, collecting a finance charge, included but not identifiable in the cash price. And it seems clear that Congress intended to reach advertising of this kind.

Accordingly, the regulation defines "consumer credit" to include credit payable in more than four instalments even though no finance charge is expressly imposed. Thus, the advertising and disclosure provisions apply to this type of credit except for those provisions that cannot be complied with because the finance charge cannot be identified. In the example given above, the merchant would have to state the price of the watch and give particulars as to the payment schedule, even though he could not give the amount of the finance charge expressed as an annual percentage rate.

Then there was the question of whether we should have more than one regulation. A few creditor groups argued that their problems were so different from those of other creditors that separate regulations should be issued exclusively covering their particular activities. We decided instead to follow in the regulation the approach taken in the Act, namely, to have a single set of rules applicable generally, but with special provisions to cover particular situations that require special treatment. For example, both the Act and Regulation Z exempt purchase-money real estate first mortgage credits from the requirement that the total dollar amount of the finance charge, as contrasted with its rate, be disclosed. We hope to prepare explanatory material relating the regulation specifically to the activities of particular industries. However, we felt that to issue separate regulations would either result in undesirable impairment of the basic principle of treating equivalent situations equally or would require useless repetition of many basic regulatory provisions in the regulations applicable to particular groups.

Now a word or two about what we did not put in the regulation. First, we omitted the formulas involved in computing the annual percentage rate, since most creditors will have no need for them. They are available, however, without charge upon written request to the Board. The Board has prepared annual percentage rate tables, consisting of two volumes, which will be available at the Board and at the Reserve Banks at a charge of $1 per volume. Volume I contains standard tables that may be used to compute the APR for most types of transactions. Volume II can be used in conjunction with Volume I for transactions with irregular payments or those involving multiple advances. For orders of 10 or more, the charge is reduced to 85 cents.

We also omitted standards for granting exemptions under section 123 of the statute. You will recall that under this section and section 226.12 of the regulation any State may apply to the Board for exemption of any class of transactions within the State that are subject to requirements substantially similar to the Federal requirements, if there is adequate provision for enforcement of the State requirements. The Board will soon publish a proposed set of guidelines to be used in ruling on State applications for such exemptions. Until these have been formulated, I hope you will understand that I am not in a position to comment on what steps should be taken by State officials to secure such exemptions. Uncertainties remain as to

how transactions should be classified for this purpose, how closely the requirements of the State law and regulations should conform to those of the Federal law and regulations, and what provisions for enforcement should be regarded as adequate.

Let me add a few words about the informational aspects involved in Regulation Z and what the Board is doing in this field.

The Board decided even before the final regulation was published that a major effort would be needed to acquaint the nation's creditors with the requirements of the regulation. Although no exact figures are available, estimates of the number of creditors covered range from 500,000 to 1 million. The nine enforcement agencies, including the Federal Reserve, are working together to make sure that all known creditors receive a copy of the regulation and explanatory material well before the July 1st deadline.

As part of our overall information program, the Board has arranged for the production of a pamphlet containing not only Regulation Z and the statute but also an explanatory series of questions and answers and some illustrative forms which a creditor may use or modify to suit his own circumstances. This pamphlet will be distributed through the nine enforcement agencies so that creditors will receive the material directly from the agency to which they should address any questions about it. Included in the pamphlet will be a listing of addresses where creditors can obtain any additional information they might need from the appropriate enforcement agency.

Distribution of this pamphlet will begin in the next two weeks. Each enforcement agency has placed its order for copies with the Board and approximately 950,000 copies of the pamphlet will be run off at this stage.

In the meantime, other aspects of the informational program have been under development. For example, the Board has arranged for the preparation of a film strip on Truth in Lending which will be made available to interested groups through the Federal Reserve Banks and other enforcement agencies. This film strip is designed to make creditors aware quickly just how Truth in Lending applies to them and what they will need to do before July 1st, such as preparing forms and educating their personnel. And tomorrow the Board's staff will initiate a series of meetings to share with staff members of the enforcing agencies informational materials we have developed. The first meeting will be held at the Board's headquarters in Washington. Subsequent meetings are scheduled this month at each of the 12 Federal Reserve Banks, with field representatives of the enforcement agencies as well as creditor groups invited to attend. This presentation will consist of an explanatory talk illustrated by slide projections of the illustrative forms which will appear in the Truth in Lending pamphlet. Copies of the talk and the slides will be distributed to the enforcement agencies and the Reserve Banks for use by them before various public groups. These phases of the information program were reviewed last week at a meeting of the Advisory Committee.

The information program has been underway since publication in mid-October of the proposed Truth in Lending regulation. Trade and consumer groups were contacted at that time to enlist their aid in distributing data as widely as possible. Special mailing lists with the names of any group or person wanting Truth in Lending material were prepared by the Board's staff during this period. These lists include business and consumer groups and individuals throughout the country. Meetings were also held with the other enforcement agencies not only to facilitate uniform enforcement of the law but also to coordinate the informational efforts. The result was a much wider distribution of the regulation when it was published in final form in early February than we could otherwise have achieved.

One week following publication of Regulation Z, the Board released a question and answer series, which has been widely published in the press and trade journals, explaining in relatively simple terms how the law and regulation will work. These questions and answers served as the basis for a similar series which will appear in the pamphlet to be distributed soon to all known creditors.

The Board is also considering further informational efforts including the preparation of booklets for specific types of credit such as mortgage credit or department store credit.

If this statement gives the impression that I take some pride in the job that has been done, it is because I do. The assignment was particularly challenging, since the Federal Reserve

System has no special qualifications as a consumer protection agency. Indeed, I hope you will reflect on the need to vest consumer protection functions in some agency better suited to the job than is the central bank, in view of the likelihood that consumer legislation will cover ever broader areas.

But to return to Truth in Lending, I am happy to review with you our efforts to implement the legislation that your Subcommittee worked so hard to enact, and to report to you that this experience has convinced me that the great bulk of businessmen can be counted on to cooperate in making credit cost disclosure effective. As your committee report on this legislation pointed out, the present confusing and conflicting methods of quoting credit costs arose in part out of difficulties with usury laws and then became imbedded in industry practice, so that no one segment of the industry has felt it could disclose an annual percentage rate without incurring a competitive disadvantage. Your efforts have made it possible for all creditors to adopt this reform simultaneously, and you have also made it crystal clear that this can be done without affecting the application of State usury laws. What remains to be done now is to make sure that this message gets to the people who will in the end make it work. This informational job is obviously much too broad for the Board to handle alone. We are preparing educational materials, but we must rely on banks, trade associations, consumer groups, educational institutions,

and others to use these materials. We have had encouraging indications of their desire to cooperate in this effort. The favorable response we have had since the regulation was released leads me to expect that Z-Day will dawn bright and fair.

Attachment

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