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Remarks of J. L. Robertson

Vice Chairman of the Board of Governors
of the
Federal Reserve System

before the

National Instalment Credit Conference
of the
American Bankers Association

San Francisco, California

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J. L. Robertson, Vice Chairman of the Board of Governors of the Federal Reserve System, urged the nation's bankers today to play a leading role in setting up educational programs for Truth in Lending which goes into effect on July 1.

Governor Robertson made his appeal in an address prepared for delivery before the National Instalment Credit Conference of the American Bankers Association in San Francisco. He directed the Board's preparation of the Truth in Lending Regulation Z which was published in final form on February 11.

Governor Robertson said there is an obvious need under Truth in Lending for banks not only to train their own employes but also to insure that the creditors from whom they purchase paper are educated to their Truth in Lending responsibilities. In some cases, he added, a bank could be held liable for improper disclosures made by the original creditors. "In order to properly protect itself, a bank must be able to determine whether disclosure statements made by creditors from whom it purchases paper comply with the law," he added.

"In terms of immediate self-interest as well as public service and good public relations, it would appear that the banking community could very effectively play a leading role in the educational process--and I hope it will do so," Governor Robertson said. He added the Federal Reserve is ready to offer all possible assistance to state banking associations in preparing educational programs on Truth in Lending but the Board's limited staff precludes participation in all of them.

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The Role of Banks in Truth in Lending

This morning I would like to do more than talk a bit about the Federal Reserve Board's new Regulation Z, "Truth in Lending". I want to suggest that you do something positive about Truth in Lending. But at the outset, I might say that as is often the case with names that attach to people or programs in their infancy, they may not always be totally appropriate for maturity. The term "Truth in Lending", which was adopted at an early stage, may not be the most appropriate name for the Act and Regulation.

It has been suggested that there is an implication that if one is required to tell the truth now, he was not doing so in the past. While this was true in some instances, as we all know, for the bulk of creditors the Truth in Lending Act merely requires that - beginning with "Z" day - the truth must be stated according to a standardized language. With the exception of perhaps the "annual percentage rate", most items which are required to be disclosed have generally been disclosed for some time in one fashion or another. What Truth in Lending does is to insure that these disclosures are made - by <u>all</u> creditors, beginning the same day - in a standardized way, so that customers may compare more readily the terms and cost of the credit which is offered to them in the market place. The Act and Regulation do this by being very detailed and specific as to the method and language of making these disclosures. Consequently, the requirement is not so much for new "truth" in lending, as for a new and uniform "language" of lending.

It has been generally accepted for a long period of time that a good deal of mystery surrounds the cost of credit. For many years it seemed to be felt that this mystery was largely unavoidable, and a natural consequence of dealing with that complicated subject of money.

Most people learned something about money and about the concept of interest in school; usually in terms of that magic number 6 per cent. Yet when one went to buy a home, he often discovered there was an additional concept called "points". It was probably a rare housewife who, if she bothered to look at her revolving charge account statement,

did not have some question about how that finance charge was computed. And I suspect that more than a few people were somewhat mystified to find that their 4-1/2 per cent auto loan actually cost more per borrowed dollar than their 6-1/4 per cent home mortgage.

I got a taste of the mystery surrounding "money" on a visit to my home town, Broken Bow, Nebraska. One of my classmates, whose name I shall not mention, had just returned to town. He was not the brightest student in school, and we all thought he might have a tough time making his way in the world. He had left town as a young man and had not been seen for many years. One day, much to the amazement of everyone, he drove up in a chauffeur-driven limousine, wearing a very expensive silk suit, and announced he was moving back to town. Everyone was astounded, for he had somehow become a wealthy man. In response to inquiries, he explained that he had gone to Chicago and invented a gadget that he could make for $1 and sell for $2. "You know," he said, "you'd be surprised how fast that 2 per cent adds up." The "mystery" that confounded my classmate has confounded and bothered a lot of people.

Increasingly in recent years as consumer credit was approaching the $100 billion mark, the voice of the consumer began to be heard to the effect that the mystery surrounding the cost of credit should be dispelled. Senator Paul Douglas introduced a credit cost disclosure bill in 1960 and spearheaded the movement for Truth in Lending until his retirement from the Senate. In a message to Congress in 1962, President Kennedy stated that one of four basic rights of the consumer was the right to be informed. After a good deal of debate, and another six years, the Congress embodied this right with reference to the cost of credit in the Consumer Credit Protection Act. That Act, which contains the Truth in Lending Act, also contains provisions regarding extortionate credit transactions and restrictions on garnishment. In addition, it sets up a national commission on consumer finance. The Federal Reserve Board's responsibility, however, was limited solely to writing

regulations for Truth in Lending covering all types of consumer credit transactions, and enforcing the Truth in Lending provisions with regard to state member banks. The Act granted the Board broad authority to write regulations that would carry out the purposes of the Act, prevent evasions of it, and aid in achieving compliance. This is what we have tried to do.

Work on those regulations began even before final passage of the bill. Initially this work proceeded on the basis of those provisions which seemed certain to appear in the final version of the Act. The Board and its staff were assisted by consultants, and aided by a carefully selected Advisory Committee of twenty men and women representing both creditor and consumer groups from all sections of the country. Together we labored on a draft regulation which was published for comment in October. In response to that publication, we received well over a thousand comments from creditors and consumers alike - many of them very constructive.

Based upon these comments and further staff study, numerous editorial and structural changes were made in the proposed Regulation, in an effort to avoid ambiguities and clarify various provisions. We hope the final product is a workable Regulation with which creditors can comply with a minimum of dislocation of trade practices, while at the same time not compromising in the slightest the disclosure of meaningful information to customers.

If you have seen a copy of the final Regulation, you may have noticed that the complicated formulas and equations have been moved from the body of the Regulation to a Supplement. This is because the typical creditor will not need to be concerned about the actual formulas for computing the annual percentage rate. He will use tables to find the rate. The Board has prepared tables for both regular monthly payment transactions with maturities up to forty years, and for irregular transactions. There will also be tables for weekly payments. The tables have been designed so that a creditor can use them in either of two ways. He can find the annual percentage rate, or APR, as it is coming

to be called, for a given dollar amount of finance charge; or, in what may become the more common usage, he can use the tables to find the dollar amount of finance charge which he must exact to obtain a certain yield.

The Board's tables are available at nominal cost from the Board or any of the Federal Reserve Banks. Tables will also be available from private chart makers, and probably from finance companies and others who finance retail credit, and this is permissible if they are prepared in accordance with our prescribed formulas. Through the use of tables, the creditors' job of arriving at the APR will be no more complicated than arriving at the amount of the finance charge for a particular transaction.

The Regulation covers a wide spectrum of credit activities - everything from the single payment note, through credit cards, and instalment financing, to home real estate mortgages and financing of vast farming operations. It will apply to a broad variety of creditors - everyone from the local merchant, the doctor and craftsman, to banks, chain stores, credit unions, small loan companies, mortgage bankers, et cetera. However, among all these classes of creditors, no single one will probably have as much cause to be familiar with Regulation Z as bankers. Not only the instalment loan department, but virtually every department in a bank will need to be intimately familiar with the requirements of Truth in Lending.

The Act covers bank credit card operations, both cash advances and the use of credit cards to make purchases. Instalment loans are, of course, covered. Real estate mortgages fall within the Act, as do agricultural loans to individual farmers. The primary test of coverage relates not to the form of the credit transaction, but to the purpose for which the credit is extended. If it is for personal, family, household, or agricultural purposes, it is covered under Truth in Lending. The fact that the loan is extended by the instalment loan department, or by the commercial loan department on a simple interest basis, or pursuant to an executive overdraft plan, is not controlling on whether or not Truth in Lending disclosures

must be made. If the credit is extended for these purposes, it is covered no matter what form the transaction takes. A simple interest loan through the commercial loan department would come under the Act if made to an individual to send his child to college, or to finance a vacation, or even for making a personal investment in the stock market.

Consequently, bankers will generally have to direct their attention to the purpose for which credit is being extended or, in the alternative, make disclosures across the board except where the credit is clearly made for business or commercial purposes. Of course, the Act only applies to credit extended to natural persons - not to partnerships, corporations, or other business entities.

Truth in Lending extends the concept of "consumer credit" in a number of ways beyond what normally might be expected. First of all, it applies to all credit for the specified purposes up to $25,000. Furthermore, some extensions of credit secured by real estate are covered regardless of the amount involved - for example, a $100,000 agricultural loan or a $50,000 mortgage on a home. Consequently, a bank cannot automatically assume that all loans of $50,000 or $100,000 or even more are outside the scope of Truth in Lending.

Advertising is also subject to the Act. Basically the advertising section requires that if you advertise any specific credit term you must give all the terms of credit in the advertisement. Furthermore, a creditor cannot advertise that specific amounts of credit are available unless he usually and customarily offers such credit. Of particular interest to banks is the fact that the advertising provisions apply to <u>any</u> advertisement, not just those of the creditor. Thus, the advertising of credit card associations, as well as of individual banks, falls within the ambit of the Act.

In general, Truth in Lending is concerned with what a creditor says, and does not impose limits on what he does. However, one portion of the Act very definitely

affects what a creditor does. That is the rescission section. Under that section a customer is given three days to cancel any transaction which involves a security interest on his residence, except in the case of a purchase money first mortgage and certain other limited exemptions. Consequently, refinancings, second mortgages, and first mortgages made other than to finance the acquisition of a home are all subject to possible rescission within the three-day period. The Regulation is detailed with regard to the method of giving the customer notice of his right of rescission, waivers of the right in emergencies, and the unwinding of a rescinded transaction.

Banks will not only need to be aware of their own responsibilities under the law; in addition, they will need to be familiar with the requirement imposed on creditors from whom they purchase paper. This is because in certain cases assignees can be held liable for improper disclosures made by the original creditors. For example, a civil action could be brought against a bank on purchased paper if it is in a continuing business relationship with the creditor who extends credit secured by real estate, unless it can show by a preponderance of evidence that it did not have grounds to believe that the original creditor was engaged in violations of the Regulation, and that it maintained procedures designed to apprise it of any such violations.

In non-real-estate transactions, written acknowledgement of receipt of disclosures constitutes proof of delivery in any action or proceeding against a subsequent assignee, except when the violation is apparent on the face of the statement. In order to properly protect itself, a bank must be able to determine whether disclosure statements made by creditors from whom it purchases paper comply with the law.

Both banks and other creditors are faced with a large and difficult task in retraining staff to the new language of consumer credit, and their responsibilities under the law. The Federal Reserve Board is acutely aware

of these problems. In an effort to be helpful, we have prepared a pamphlet which is being distributed by the nine enforcement agencies in an attempt to reach all creditors affected by the Act. The pamphlet contains general questions and answers and sample forms, as well as the Act, the Regulation, and other helpful material.

The Regulation itself has been drafted so that it can serve as a handbook to Truth in Lending. In general, the statutory provisions are restated in the Regulation. We have attempted to draft it in a fashion that will enable creditors, their employees, and consumers to find the answers to their questions without having to jump back and forth between statute and Regulation. We have also begun the preparation of more detailed material relating to the more complicated areas of the Regulation. We have been and will continue to work with trade associations to aid them in preparing materials tailored to the specific needs of their members.

Nevertheless, we are aware that there will be problems in shifting from old procedures to new ones. They will likely be similar to the problem of the Australian who saved up his money to purchase a new-fangled type of boomerang. His neighbor asked him whether he was having any trouble getting accustomed to the new boomerang. He replied: "The new one is working fine, but I am having a heck of a time getting rid of the old one; whenever I try to throw it away, it keeps coming back." Like the old boomerang, some of the old practices may be a bit difficult to get rid of.

Since the banking community is affected to such a degree by Truth in Lending, it would appear that it, more than any other class of creditors, would have a particular interest in the development and dissemination of educational materials. There is, of course, the obvious need for material designed to inform bank employees about Truth in Lending.

Beyond this, however, especially in view of the problems of assignee liability, it would appear to be in the best interests of banks to attempt to insure that the

creditors from whom they purchase paper are educated to their Truth in Lending responsibilities. The job of protecting itself against liability on purchased paper will be made easier if a bank can have some assurance that the sellers know what they are required to do under the Act. Our volume of inquiries has demonstrated the thirst of both creditors and consumers for knowledge about the Act. This interest indicates that banks would find a ready-made audience for programs geared to their customers in the business community, designed to bring about a broad public understanding of Truth in Lending.

In terms of immediate self-interest as well as public service and good public relations, it would appear that the banking community could very effectively play a leading role in the educational process - and I hope it will do so. Parenthetically, let me say that the Federal Reserve System stands ready to offer all possible assistance to state banking associations in the organization of educational programs. Our limited staff precludes participation in all of them, but both the Board and the twelve Reserve Banks are available for consultation in setting up such programs.

Perhaps I should mention one issue which has prompted more inquiries than any other - the matter of state exemptions. The Act contains a rather unique provision. It specifies that the Board shall exempt from federal requirements any class of credit transactions within a state, if it determines that the class of transactions is subject to state requirements substantially similar to those imposed under federal law, and that there is adequate provision for enforcement. However, the exemption may only be granted with regard to the disclosure and rescission provisions of the Act - not with regard to advertising. Advertising of credit must, under the Act, remain subject to federal jurisdiction.

We are facing a number of difficult issues with regard to state exemptions; for example, the formulation of appropriate procedures and criteria for handling applications for exemptions and the specification of tests

that must be met by any state which applies. But the difficulties will be resolved and Supplement II to the Regulation will be published for comment shortly. No application for exemption will be accepted from any state until final publication of that Supplement.

There has been a great deal of discussion of the Uniform Consumer Credit Code with reference to possible state exemption. Initially, I want to make it clear that the Board will concern itself solely with one issue with reference to the Code - whether or not the adoption by a state of the Code's Truth in Lending provisions will qualify it for an exemption under the federal Act. It is not my intention to join the debate on the Code, either pro or con, as it relates to interest rate ceilings, free entry, creditor remedies, or the other subjects treated by it.

In view of the intended introduction of the Code in a number of state legislatures which began meeting this fall, we were requested to give a preliminary opinion as to the possibility of exemption. In response to that request, the Code was reviewed in comparison to the federal statute. The review was made on a straight statute-to-statute basis without reference to the federal regulations which were then still in draft stage. On the basis of that review, it was determined that the statutory provisions of the Code had a high degree of similarity to the federal statute. Nevertheless, we had to point out that a determination with regard to "substantial similarity" of state requirements to federal requirements necessarily involved consideration of not only state and federal statutes, but also state and federal substantive regulations, and especially to provisions for enforcement. Consequently, we were unable to give an advance commitment on exemption.

In closing, I would remind you that the Board was reluctant to undertake the primary responsibility for Truth in Lending. Our main function and expertise is in the field of monetary policy, and not consumer legislation. Nevertheless, Congress having given us the job of

writing the Regulation, we undertook to write the best one we could. Many people have been kind enough to say they think the time and talents invested in the project have paid off. At any rate, we did our best. And I hope the Regulation represents a workable and fair approach to the numerous problems raised by this legislation. However, the writing of this particular Regulation did not turn the Federal Reserve Board into this country's expert on consumer affairs. Our primary job remains that of formulating and executing monetary policy as the central bank of the nation. One need only glance at the daily newspaper to see that we have plenty of work cut out for us in this sphere alone. Accordingly, I hope the Congress will turn to some other agency for solutions to other consumer problems - an agency whose staff, existing authority, and expertise are better suited to providing consumer protection.

Having written the Regulation on Truth in Lending, we will enforce it with respect to state member banks, and we will endeavor to coordinate enforcement activities by other federal agencies in an effort to insure that the Act is applied evenly and fairly to all classes of creditors. We will also undertake the task of sparking and coordinating an educational campaign in which, I trust, the banking community will play a leading role.

I hope the bankers of this nation will not approach Truth in Lending with trepidation, but rather will look upon it as a challenge and an opportunity, not only for community service but also as a means of fostering better understanding of consumer credit among all Americans. Bankers already enjoy a high level of public trust in today's economic mainstream. Truth in Lending can only serve to heighten that trust, especially if all banks take an active hand in seeing to it that their customers and the public in general are well informed.