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Statement by

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Board of Governors of the Federal Reserve System

before the

Committee on Banking, Housing and Urban Affairs

United States Senate

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It is a pleasure for me to appear before this Committee on the important subject of Truth in Lending simplification. Since I have been appointed to chair the Board committee that has responsibility for Consumer Affairs, I look forward to working with you on this and other matters, and I anticipate a cooperative and constructive relationship.

Before addressing the principal topic of this hearing, I would like to draw attention to a problem that has arisen regarding the recently enacted Right to Financial Privacy Act, which is Title XI of the Financial Institutions Regulatory and Interest Rate Control Act of 1978. Section 1104(d) of that law requires all institutions subject to the Act to notify promptly all customers of their rights under the law, and directs the Board to prepare a model statement of customer rights. Although the Board does not have rule-writing authority under this law, we have been asked to provide guidance as to the meaning of this notification requirement.

The Act makes no distinction between active accounts and inactive and closed accounts. Thus, it appears that all accounts must receive the statement of customer rights. Not only would this notification requirement be extremely costly and burdensome but a typical family would receive several identical statements. A Senate bill, S. 37, introduced by Chairman Proxmire, would repeal § 1104(d). The Board's Consumer Advisory Council did not urge repeal of this section but adopted a resolution recommending that the statute be amended to require the statement to be delivered only at the time access is sought

to a customer's records. The Board has endorsed that recommendation. In so doing, the Board was influenced by the fact that this amendment would get the information into the hands of customers at the time they need it.

Turning now to Truth in Lending simplification, the Board continues to believe in the soundness of the basic concepts of S. 2802, which was passed by the Senate last session. The Board supports enactment of S. 108 introduced by Chairman Proxmire. Common sense indicates that the Act and, I should add, the regulation can and should be improved and simplified so that they will be more effective and less burdensome.

The basic cost information most needed by consumers in shopping for credit should be emphasized, that is, the annual percentage rate, the total finance charge, and the payments schedule. Significant information that is less important for shopping purposes should be summarized, but with the details left to the contract. Information which detracts from basic information should appear elsewhere with a reference to its availability.

The 1977 Consumer Credit Survey, which was funded by the FDIC, the Comptroller of the Currency, and the Board and conducted by the University of Michigan's Survey Research Center, reinforces the approach taken by S. 2802. The Survey asked consumers what credit terms they would want to know when financing a car. The overwhelming majority responded that the annual percentage rate was the most important.

At another point in the interview, respondents were given a list of S. 2802's seven disclosures and were asked to rank their importance. The results show annual percentage rate, size of monthly payment, and finance charge to be far more important to consumers than other terms. In summary, the Board believes that last session's simplification bill provides an excellent basis for the continued consideration of Truth in Lending simplification.

In addition to considering Truth in Lending simplification during the last session, this Committee favorably reported a bill to regulate the consumer aspects of electronic fund transfers. Many of the Committee's recommendations were ultimately enacted as Title XX of the Financial Institutions Regulatory and Interest Rate Control Act of 1978. The portions of the act dealing with limitations on a consumer's liability for unauthorized transfers and for limitations on unsolicited distribution of EFT cards go into effect this month. The rest of the act goes into effect in May, 1980.

The Board has begun the process of writing regulations to implement the act. In the course of this process, we have become concerned that consumers will encounter unnecessary difficulty in understanding the rules provided by the new Act and confuse them with the provisions of the Truth in Lending and Fair Credit Billing Acts. The latter acts govern credit card and overdraft type credit.

Consumers will be particularly confused in cases where a single card will perform functions subject to the Fair Credit Billing

Act (such as a credit purchase) and others subject to the Electronic Fund Transfer Act (for example, a cash withdrawal from an electronic terminal). In some cases, a single transaction may be subject to both acts; for example, a cash withdrawal from a terminal may debit the customer's checking account and access a line of credit at the same time. Even without these complex plans, consumers should not have to learn different rules for the pieces of plastic lying side-by-side in their wallets. In order to minimize consumer confusion, the Board recommends that the acts be amended to provide one set of rules governing both credit and electronic fund transfer transactions except where compelling policy considerations dictate different treatment. These recommendations are based upon the assumption that consumers will be best served by one set of rules which in time they will learn and use.

The Board's specific recommendations are:

1. The Truth in Lending Act imposes a $50 limit on the liability of a credit card holder when a card is lost or stolen. The Electronic Fund Transfer Act has a $50, $500, and unlimited liability structure. The Board recommends that there be a single set of rules governing liability for unauthorized use. The $50 limit of Truth in Lending is not sacred, and the concept of Electronic Fund Transfer that culpable consumers should carry a heavier responsibility has appeal. Nonetheless, the Truth in Lending approach is more protective of consumers and, we believe, will make electronic payment systems more acceptable to the public. Based upon the experience of credit card

issuers which often do not impose even the $50 liability for credit card loss, electronic fund transfer suppliers should not be materially harmed by this amendment.

2. Under the Fair Credit Billing Act, a consumer must write to the creditor in order to take advantage of the dispute resolution rules of the Act. The Electronic Fund Transfer Act permits oral notice to the institution, although written confirmation can be required of the consumer. An informal Board study indicates that less than 1% of consumers with questions about their bills follow the formal procedures of the Fair Credit Billing Act. Consumers usually telephone, and the lack of formality should not remove them from the protections of the Act. The Board recommends that the Fair Credit Billing Act be amended to incorporate the oral notice provision of the Electronic Fund Transfer Act.

3. When an error is alleged under the Electronic Fund Transfer Act, the institution must within 10 days either complete its investigation or provisionally recredit the consumer's account. When an error allegation is received under the Fair Credit Billing Act, the creditor must either resolve the dispute or send an acknowledgment within 30 days. The Board recommends that both acts be amended to provide parallel timing requirements as follows:

(a) Under the Electronic Fund Transfer Act, require notice within 10 days informing the consumer of the correction, or, if the institution believes no error occurred,

a written explanation of the basis for that belief. In the alternative, require a written notice of the provisional recredit; and

(b) Under the Fair Credit Billing Act, require notice to the consumer of the correction of the error within 10 days, or a written explanation of why the creditor believes no error occurred. In the alternative, require a written notice that amounts in dispute need not be paid.

The current time limits for resolving disputes are 45 days under the Electronic Fund Transfer Act and two billing cycles but not more than 90 days under the Fair Credit Billing Act. The Board recommends that the Electronic Fund Transfer Act be amended to conform to the Fair Credit Billing Act so that both laws would require resolution within 90 calendar days. Lengthening the Electronic Fund Transfer Act limit will not hurt consumers because their funds will have already been provisionally recredited.

4. The Board recommends that the annual notice of rights under the Electronic Fund Transfer Act and the semiannual notice of rights under the Fair Credit Billing Act be eliminated. In their stead, we recommend that periodic statements contain a summary notice disclosing the existence of the rights and informing persons how to obtain a complete explanation. Since it is normally information on periodic statements which triggers a dispute, we believe that consumers are

better served by a short notice at the time a dispute arises than they are by a lengthy explanation once or twice a year.

5. The Truth in Lending Act prohibits the unsolicited issuance of credit cards, while the Electronic Fund Transfer Act permits the unsolicited issuance of cards provided they are not validated. Because many institutions are offering cards with both credit and electronic fund transfer features, the Electronic Fund Transfer Act's more competitive approach may be frustrated by the Truth in Lending Act's absolute prohibition on unsolicited issuance. One solution is to conform the Truth in Lending Act to the Electronic Fund Transfer Act to permit the unsolicited issuance of unvalidated credit cards.

6. Both the Electronic Fund Transfer Act and the Fair Credit Billing Act provide for "error" resolution procedures. The acts define mere requests for clarification or documentation as "errors." The Board recommends that the error definitions be amended to limit the concept to cases in which the consumer suspects a mistake or discrepancy. Institutions should not be put to the expense of complying with the error resolution procedures each time a consumer calls for information for business, tax or other purposes. The Board already has the authority to define additional errors by regulation and, therefore, can prevent any loopholes from developing.

7. Finally, the staff has received a number of inquiries from consumers and creditors asking whether the Fair Credit Billing Act permits creditors to impose charges for providing documentation or investigating

errors. In some cases, these charges appear to be quite substantial, and in others, they are open ended, for example, $5 per hour for an investigation. The Board recommends that both the Fair Credit Billing Act and the Electronic Fund Transfer Act be amended to prohibit the imposition of such charges. While Regulation Z prohibits these charges where a customer's allegation of error proves correct, we believe that permitting these charges at all serves to discourage customers from exercising their right to assert errors.

These seven recommendations and a few technical problems the Board's staff has discovered dealing with matters such as rule writing authority could be included in the present bill or in a separate bill. In either case, the Board believes it is important that the legal relationship between electronic fund transfers and the credit transactions be clarified and that the consumer be offered a rational, common-sense framework.

I appreciate the opportunity to appear. The Board commends this Committee for its tenacity in dealing with this difficult subject.