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Statement of

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before the

Subcommittee on Financial Institutions

of the

Committee on Banking and Currency

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I appreciate this opportunity to appear before your Committee to present the views of the Board of Governors on S. 721.

Briefly, S. 721 would add to the Truth in Lending Act provisions requiring the Board to regulate the issuance of unsolicited credit cards, and limiting the liability of consumers for the unauthorized use of credit cards. The bill would apply to credit cards of both bank and nonbank issuers.

Regulation of Issuance of Unsolicited Credit Cards

Section 2 of the bill would require the Board to prescribe regulations "governing the conditions under which" unsolicited credit cards might properly be issued. The Board's regulations would be required to prescribe "minimum standards" for card issuers in checking the "credit worthiness of prospective cardholders" in order (1) to protect consumers against "overextending themselves" through the use of unsolicited credit cards, and (2), when the issuer is a Federally insured bank, to "safeguard the safety and soundness" of the bank.

We, at the Board, of course, are more familiar with credit card arrangements of banks than with the credit card programs of nonbank issuers. Banks have found that the most effective way to obtain customers for a new credit card plan is to mail a large number of unsolicited cards. This procedure resolves simultaneously the

problem of having enough merchants signed to participate in the bank's plan to make the card useful to its customers, and of having enough cardholders to make the plan attractive to merchants. Although the unsolicited mailing of credit cards by banks has involved some problems, there have been no developments to date that, in the Board's judgment, would warrant preventing this method of card distribution. If this method of card issuance were prevented or restricted to the extent that it would no longer be practicable, banks would be seriously hampered in launching credit card plans. This would give those banks already in the field a protected position, discouraging competition.

While S. 721 would not prohibit unsolicited mailings, it would provide for Federal regulation of such mailings. In determining whether such regulatory authority is needed, you will presumably want to consider whether recipients of unsolicited cards need government protection from incurring too much debt through the use of the cards, and whether regulation is needed to guard the safety and soundness of the issuing banks. The evidence available to the Board suggests that this authority is not needed for either purpose. The Board has instructed its examiners to make sure that banks realize the importance of developing and carefully screening mailing lists for credit cards from their own records and, in so doing, checking the credit-worthiness of intended credit card recipients. The other Federal banking agencies are following similar practices with respect to the banks they examine.

Under the criteria being followed by banks for issuing credit cards, bank credit card operations are generally sound from the point of view of the consumer as well as the bank. Banks are taking care to see that the people to whom credit cards are sent are able to meet obligations within the established limits.

A review of reports of examination for 74 State member banks with credit card plans^{1/} indicates that they have exercised prudence in credit card management.

While unsolicited mailings were found to have been the principal means of distributing cards, no significant problems were uncovered--certainly none of the magnitude of the difficulties surrounding the Chicago episode of late 1966 and early 1967. Ten of the 74 banks mailed cards on an unsolicited basis without obtaining adequate credit information on potential customers.

Other unsatisfactory features drawing comments of examiners are as follows:

<u>Problem</u>	<u>Number of banks</u>
Lack of control over unissued cards	1
Inadequate collection policies and practices	5
Inadequate procedures for reclaiming credit cards when accounts became delinquent	2
No preprinted expiration dates ^{2/}	2
Lack of control on customers exceeding limits	4
Customers not informed of credit card limits	1
Slow processing of items	4

1/ As of June 30, 1968, there were 64 State member banks with credit card plans. On last December 30, the number was 65, and it was 93 on June 30, 1969. Since State member banks are examined once each year, the reports on 74 banks provide almost complete coverage since the guidelines were recommended in the late summer of 1968.

2/ Plans became effective in the 1950's, and no problems have been encountered.

In each of these instances, the unsatisfactory features noted by Federal Reserve bank examiners were corrected by management where problems existed. Specifically, in the ten cases involving lack of adequate credit information, practices were changed promptly, and such information is now obtained before cards are granted.

Additional evidence as to bank credit card distribution practices is provided by a survey undertaken by the Federal Reserve Banks in August this year. The survey covered the practices followed by Federal Reserve member banks which began bank credit card plans between June 30, 1968, and the end of August 1969. The results are summarized in the following table.

Bank Practices in the Distribution
of Credit Cards, by Federal
Reserve District

Federal Reserve District ^{1/}	Number of Banks Starting Plans, July, 1968- August, 1969	Use of Unsolicited Mailing	Use of Outside Lists	Use of Pre-mailers
1. Boston	6	All	None	All
2. New York	22	Virtually all	None	Most
3. Philadelphia	0	--	--	--
4. Cleveland	26	Most	Few	Most
5. Richmond	52	Virtually all	Few	Most
6. Atlanta	75	Most	Few	N.A.
7. Chicago	5	All	None	N.A.
10. Kansas City	13	Most	One	N.A.
11. Dallas	16	Most	None	Most
12. San Francisco	21	Some	None	Some

^{1/} Information on new bank credit card plans started in the St. Louis (8) and Minneapolis (9) Districts was incomplete and could not be used in this tabulation.

Several conclusions can be drawn from this survey: Unsolicited mailing of cards is generally used in starting new plans; but in some Federal Reserve Districts, an application-type system is also used frequently. In most cases, mailing lists are compiled from present customers of the banks, and these are screened before cards are mailed, although a few banks were reported to have used outside sources (such as directory services, credit bureaus or credit rating firms) in adding to mailing lists that were composed primarily of their own customers, and one bank was reported to have used a list of names obtained outside the bank without screening it.

Where information was available from the Federal Reserve Bank survey, it indicated that pre-mailers were generally used, as recommended in the Federal Reserve guidelines. These pre-mailers advise the customer that a card is being sent unless the customer indicates to the bank that he wishes his name removed from the list. In this way the customer is able to refuse a card before it is sent. The pre-mailer also helps reduce the prospect of fraud by alerting the customer to expect the card and also informs the bank of changes in addresses. During a single week this summer, for example, more than 2 million bank credit cards were mailed in New York when a new plan was adopted by a group of three major banks. The fact that these cards had been preceded by pre-mailers undoubtedly contributed to holding reported losses or thefts of cards during this mailing to 250 cases. On the other hand, the pre-mailer still puts the

burden on the potential card recipient to take a positive step to stop the card's arrival if he does not want it.

A handful of banks have sent cards via registered mail, a practice that places an unreasonable burden on consumers. Since registered mail must be accepted by a responsible person at the address indicated, in many cases this means that the potential cardholder must make a special effort to pick up the letter at his post office. Not infrequently this means taking time off from work (many times without pay) incurring transportation costs and other inconveniences. The main objective of employing the registered mail technique is to minimize the exposure of the issuer to financial losses associated with the distribution of its own card through unsolicited mailings. The consumer should not be asked to spend his time or money (or both) on a trip to the post office to provide this protection for card issuers.

As you know, bills have been introduced in the Congress that would make unsolicited credit cards "nonmailable matter" unless (a) they are sent by the issuer by registered mail, restricted to delivery to the addressee only (b) the envelope is marked "unsolicited credit card--addressee may refuse", and (c) the issuer guarantees payment of return postage.

In reporting on these bills the Board suggested amendments to eliminate the requirement for registered mail and require issuers to use unmarked envelopes enclosing an unmarked return envelope

with the card in it, and a notice that the card may be refused by depositing the unopened return envelope in the nearest post office or letter box. This suggestion, by eliminating the requirement for registered mail, would seem to overcome a real source of great annoyance of intended card recipients. Furthermore, the use of unmarked envelopes would seem clearly to reduce security problems in the distribution of credit cards.

Let me turn now to the question whether individual consumers might get deeply into debt because of so-called "easy credit" extended through bank credit card plans. It is difficult to measure this risk. Under most of the plans the customer is given an initial credit limit of \$300, although the limit may be higher for customers with the best credit ratings. The average amount outstanding per active bank credit card account was about \$180 on June 30, 1969. These figures suggest that the unsolicited bank credit card is not often a cause in itself, of a customer incurring extensive indebtedness.

In addition, the credit standards are aimed at middle income consumers who, by and large, can afford to contract debt within the applicable limits. This is indicated also by the Board's recent Survey of Consumer Awareness of Credit Costs, which was conducted in May and June of this year in connection with our responsibilities under the Truth in Lending Act. Tabulations from this survey, which sampled more than 5,000 representative households, are now becoming available; information on ownership of bank credit cards has been obtained in some detail. On an overall basis, 1,324 households--or slightly more than 25 per cent of the total number sampled--replied "yes" when asked "Do you have a credit card issued to you by a bank?".

Responses to the ownership question, when analyzed by education and income levels, showed results that one might have expected. Ownership of at least one bank credit card tended to rise significantly as the educational level of the head of the household increased. Only 13.7 per cent of those with a grade school education or less held bank credit cards, while nearly 40 per cent of the college graduates sampled owned cards. Similarly, less than 10 per cent of the households with a total family income under \$3,000 in 1968 reported ownership of cards, but more than 40 per cent of families with annual income above \$15,000 held cards. These figures tend to substantiate our belief that the practices currently used to issue bank credit cards have not placed an unduly large number of cards in the hands of "unsophisticated" potential users.

To conclude, then, Mr. Chairman, with respect to section 2 of the bill, the Board recommends against its enactment as introduced. If your committee determines that restrictions should be placed on unsolicited mailings, we urge that you follow the course you adopted as to S. 823, the Fair Credit Reporting Act. As you recall, the introduced version of S. 823 would have required the Board of Governors to prescribe regulations governing the operations of credit reporting agencies. Before reporting the bill to the Senate, your committee eliminated this regulatory authority, and instead spelled out in the bill, itself, rules and procedures relating to consumer reports. It should be possible to do the same thing for unsolicited mailings of credit cards, by spelling out in the statute whatever restrictions you may conclude are needed. One possibility, as I have mentioned, would be to require issuers to provide recipients of unsolicited cards with a simple means of returning them.

If, however, you should decide that restrictions are needed but cannot be specified in the statute, and therefore must be imposed by administrative regulation, we strongly urge that this responsibility be vested in some agency other than the Board. As Governor Robertson testified at your hearings on S. 823, assignment to the Board of wide-ranging duties in the general area of consumer protection would be inconsistent with effective performance of our primary duties in the field of monetary policy. In view of the increasing interest Congress is showing in enacting legislation to protect consumers, we believe responsibility for implementing it should be vested in an agency more familiar with consumer problems and more expert in coping with them.

Consumer Liability for Fraud Losses

Section 3 of S. 721 would place a maximum limit of \$50 on the liability of any person to whom a credit card had been issued for any unauthorized use of the card. This liability could attach only if (a) the cardholder had accepted the card by requesting, signing, or using the card; (b) the card issuer had notified the holder of his potential liability under the card; (c) the issuer had provided a means of identifying the user of the card as a person authorized to use it; (d) the unauthorized use occurred before the holder had notified the issuer of the loss or theft of the card; and (e) the issuer, upon receipt of such notice, had taken steps to guard against the unauthorized use of the card.

The Board would be required by the bill to prescribe regulations concerning the notice to be given to a customer as to his potential liability under a card. Furthermore, section 105 of the Truth in Lending Act would apply to all of the provisions that would be added to the Act by S. 721, and section 105 requires the Board to prescribe regulations to carry out the provisions of the Act.

Of course, the critical question of customer liability for fraud losses where he fails to receive a card mailed to him is not entirely a problem of unsolicited mailing. The same problem obviously could arise concerning requested cards and even renewals of existing cards. Furthermore, cards can be, and sometimes are, fraudulently used after their acceptance or use by the customer.

Most banks do not attempt to collect from the intended recipient of a card for the unauthorized use of the card that is lost or stolen before it is received or otherwise accepted by the intended recipient. If there are any banks that attempt to make collections in such cases, we are not aware of them. Moreover, it seems evident that from a legal standpoint, efforts to collect in such cases would probably not be successful, even in States that have no statutory protection for consumers in such situations.

In the case of misuse of cards stolen or lost after being accepted by the cardholder, it is generally true that the customer has no liability for fraud losses after the bank has been informed that the card is lost or stolen. As for the liability of the cardholder prior to informing the bank, there is much more variation in banks' policies. Some banks seek to collect in these cases from the customer for all losses occurring before the bank was notified. Others do not attempt to collect even where the customer does not report the loss or theft of the card. Still other banks (and some State statutes) specify an upper limit on the dollar liability of the customer.

As we understand the situation, the majority of banks follow the practice of absorbing losses, but do not reveal the policy to their customers for fear they might be unduly careless in their handling of the card. This is often true even where the banks inform the customer that his liability is limited to, say, \$50 or \$100. These announced limits are primarily designed to make the customer take care in the handling of the card and to stimulate prompt reporting of lost or stolen cards. Actual policy, therefore, is often more lenient than announced policy.

We would like to see all banks inform their credit card customers of their potential liability. This and the related aspects of customer liability are too important to leave to uncertainty on the part of the customer. Failure to disclose the terms of liability are not tolerable standards of business conduct for card issuers.

The Board, accordingly, favors enactment of legislation along the lines of section 3 of S. 721 limiting the liability of issuers of credit cards for any unauthorized use of their cards. A few states have enacted legislation in this area, but their approach has not been uniform. While it is not self-evident that a Federal law is needed, the situation suggests that Federal legislation might be preferable in view, particularly, of the regional and national scope of some credit card operations. The Board believes, however, that such legislation should be drafted so as not to require implementation by regulations. In effect, such legislation

would constitute a defense for the person to whom a credit card has been issued in any action by the issuer to enforce liability under the card. This seems to be the case with respect to the Massachusetts statute which, Mr. Chairman, I believe you indicated was a pattern for this part of S. 721. In the Board's judgment, the subject is one that lends itself to legislative specification. Accordingly, implementing regulations would not be needed.

If appropriate legislation with respect to consumer liability were enacted, the Board believes that the major problem associated with unsolicited mailings of credit cards would be solved. Obviously, to be effective and acceptable, such legislation should apply to all credit cards, including travel and entertainment cards, gasoline cards, and so on, as well as bank credit cards. The scope of S. 721 follows this principle.