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Statement by

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Member, Board of Governors of the Federal Reserve System

before the

Subcommittee on Consumer Affairs

of the

Committee on Banking, Currency and Housing

United States House of Representatives

July 8, 1975

Mr. Chairman and members of the Committee, it is indeed a pleasure to have the opportunity of appearing before this Subcommittee on Consumer Affairs to present the Board's views on the Consumer Leasing Act of 1975, H. R. 4657. The Board is particularly pleased to see legislative action beginning in this area, since the need for consumer leasing disclosures has been of some concern to us over the last two years. In its Annual Report to Congress on Truth in Lending for 1973, the Board pointed out several disclosure problems in the area of consumer leasing and suggested that the Congress might wish to examine this rapidly expanding field. The additional step of recommending legislative provisions was taken by the Board in its Truth in Lending Report for 1974, and I was gratified to note that many of the provisions of the Board's proposal have been incorporated into H. R. 4657.

I would like to state at the outset that the Board believes that consumer leasing is an appropriate method of utilizing and, in some cases, of purchasing consumer durables. Consumer leasing has experienced rapid growth within the last decade. This growing popularity suggests that the public is increasingly coming to view leasing as a viable alternative to credit purchases for some products.

Available statistics on the growth of consumer leasing indicate that the so-called "big-ticket durables," such as automobiles, color television sets, and home furnishings are the most common goods leased by consumers. Automobiles presently constitute the most

popular leased goods, and this aspect of consumer leasing will no doubt absorb much of the Subcommittee's attention during its deliberations on this legislation.

Automobile leasing has experienced rapid growth over the past decade. According to statistics from the National Automobile Dealers Association, in 1965, more than 1.5 million, some 14 per cent of the total number of automobiles produced, were leased, and one-fifth of this total was leased to individuals. By 1970, the percentage of automobile production that was leased had grown to 24 per cent (2.6 million), more than a quarter of which represented leases to individuals. As of 1974, 2.8 million, about 26 per cent of the total number of cars made, were leased, and 36 per cent of this total was leased to individuals. Thus, over almost a decade, the percentage of total automobile production leased to individuals has tripled in size: from less than 3 per cent in 1965 to 9.2 per cent in 1974. Projections from auto makers in Detroit, moreover, estimate that 80 per cent of the growth in leasing through 1980 will be seen in leases to individuals.

The Board's concern with consumer leasing is that presently, except for provisions made in a few State statutes, there is no requirement that a standardized aggregate cost disclosure be given the consumer when he leases goods under a long-term contract. Truth in Lending's major purpose has been to facilitate meaningful consumer shopping of the credit market by providing standardized

disclosures of credit costs. Without comparable disclosures on consumer leasing, it is difficult, if not impossible, for consumers to shop in the expanding leasing market. Our hope is that the passage of this type of legislation will help consumers not only to compare leasing alternatives, but also to compare lease transactions with conventional credit sales.

The need for comparability in disclosure between lease and credit transactions is particularly important, because many consumer leasing arrangements now prevalent in the market are essentially the equivalent of credit sales. The terminology of the trade, for example, refers to certain lease agreements as "financing leases." The fact that many of these leases are essentially equivalent to credit sales is not coincidental. For example, both the Comptroller of the Currency as to national banks and the Board in its rules governing bank holding company activities require that leases entered into by these institutions be the functional equivalent of a credit transaction and have thus limited the asset risk that banks and bank-related lessors may take in engaging in leasing operations. These rules, designed to protect the safety and soundness of banks in which the public deposits its funds, have the effect of placing the risk of any unforeseen deterioration or depreciation of the product leased on the lessee. Thus, legislation to protect the consumer by requiring proper disclosure of the consumer lessee's risks becomes all the more important. Otherwise, the lessee may unknowingly undertake nearly all the burdens of ownership, without the benefit of title or adequate cost disclosures.

It is presently not possible as a practical matter to require adequate cost disclosures on leases under the Truth in Lending Act. The Truth in Lending Act brings certain leases within its disclosure requirements, through the definition of credit sale contained in § 103(g). However, these requirements apply only with respect to those leases which contain provisions permitting the lessee to become the owner of the goods leased "for no other or a nominal consideration." The Board might conceivably expand this provision by adopting a broad definition of what constitutes nominal consideration. However, this would still not accomplish the purpose of assuring that adequate cost disclosures are given in all consumer leases, such as those in which there is no option to purchase. In addition, we believe that the number of leases with nominal purchase options is quite small.

The focal point of the Board's concern is thus those long-term leases of personal property to be used for personal, family or household purposes, which typically have a maturity approaching that of a credit sale agreement, and potentially bind the lessee to the payment of an aggregate sum substantially equivalent to the value of the goods leased. This does not include the short-term convenience leasing such as rent-a-car arrangements.

We feel that standardized disclosures, comparable to those set forth under Truth in Lending, should be required for lease advertisements as well as for consumer lease transactions. However, we do not believe that rate disclosures, analogous to the annual

disclosures of credit costs. Without comparable disclosures on consumer leasing, it is difficult, if not impossible, for consumers to shop in the expanding leasing market. Our hope is that the passage of this type of legislation will help consumers not only to compare leasing alternatives, but also to compare lease transactions with conventional credit sales.

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percentage rate under Truth in Lending, are practical. The development of lease rate disclosures is impractical, we feel, because of the difficulty of determining what common costs should be isolated in the computation of such rates.

I would now like to comment on two sections of H. R. 4657 that we regard as highly important. The first is § 183 which sets a limitation on a consumer lessee's liability. This provision of the bill addresses the liability that the lease may impose on a consumer lessee at the end of the lease term. It is not uncommon for consumer leases to provide that upon the expiration of the lease, the product will have a stipulated depreciated value and will either be purchased by the lessee or sold to an independent party. Under the terms of such an agreement, if the product is sold and brings less than the depreciated value stipulated in the contract, the lessee is liable for the difference; if it brings more, the lessee is entitled to the surplus.

For example, a typical two-year auto lease on a \$5,400 car might call for 24 \$100 instalment payments and set an end-term depreciated value of \$3,000 on the car. Under such an agreement, the lessee may have no understanding of how much the lease may cost, unless he can accurately predict the second-hand market value of the product. For example, in this case, the depreciated value of the car might be \$2,500, which under the lease contract

would leave the lessee liable for an additional \$500 balloon payment. Thus, if the contract sets an unrealistically high depreciated value on the leased goods, the contingent liability of the lessee will increase accordingly, and the lessor can offer deceptively low monthly rental payments to an unwary public.

Under § 183, the lessee's contingent liability would be limited to twice the average monthly rental payment, except for additional charges imposed for lessee default or for damage to the leased goods in excess of normal wear and tear. The section is thus designed to protect the consumer lessee in two ways. First, it is designed to notify the consumer of his maximum contract liability under the lease. Secondly, by incorporating a monthly payment factor into the computation of the maximum end-term liability figure, the section seeks to assure that the lessor will price the rental instalments of the goods leased sufficiently high to cover expected depreciation and thus avoid leaving the consumer lessee with an unduly large balloon payment at the end of the lease term.

Let me reiterate at this point what the Board stated in its 1974 Annual Report: We are not committed to a two-month formula. Another formula, such as three months or 15 per cent of rental payments over the life of the lease, may work as well or better. The Board would hope that whatever formula may be chosen will reflect industry experience in accurately setting depreciated values. However, we believe that some limitation tied to instalment payments is highly

desirable. Such a limitation reflects the fact that typically the lessor is better able to predict residual values than is the lessee. In addition, this limiting factor reduces the possibility of a large contingent liability on the part of the lessee and gives the lessee a "bottom line" price tag which may facilitate comparative shopping.

The second provision on which I would like to comment is § 105 of H. R. 4657. This section places an effective date for this legislation as the first day of the second full calendar month after the date of enactment. As we have mentioned before, we believe the time that the Congress grants to an agency to implement a given statute has a direct bearing on the quality and effectiveness of the agency's regulations. We believe the two-month period accorded under H. R. 4657 is far too short to develop well-considered implementing regulations, which are fair to the lessee and lessor alike. Time for consultation with both business and consumer groups is needed. Time is also needed to comply with the Administrative Procedure Act which requires publication of proposed rules for comment. Responding comments must be carefully analyzed. Finally, if the regulations are to be properly complied with, industry must have some time to study them and to change business procedures. Therefore, the Board would respectfully urge that a minimum of 12 months be provided before this Act is to become effective.

In closing, I would like to commend this Committee for the action taken in this area. This new and expanding alternative to credit purchases, we feel, merits careful attention, and we are

confident that the Congress will provide a statutory basis to assure that the consuming public will have the necessary information to make intelligent shopping decisions in lease transactions. The Board, of course, stands ready to assist in the implementation of such legislation, and I would be pleased to respond to any of your questions.