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Statement by

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before the

Subcommittee on Consumer Affairs

of the

Committee on Banking, Housing, and Urban Affairs

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I appreciate the opportunity to appear before this Subcommittee to offer the views of the Federal Reserve Board on proposed legislation dealing with the Equal Credit Opportunity Act and consumer leasing. Three bills are before the committee which would amend the Equal Credit Opportunity Act: H. R. 6516, S. 483 and S. 1927. Two legislative proposals to regulate consumer leasing, S. 1900 and S. 1961 are also under consideration. I would first like to address myself to the suggested amendments to the Equal Credit Opportunity Act.

The three Equal Credit Opportunity bills would add new classes to the existing categories of sex and marital status. H. R. 6516 would add the categories of race, color, religion, national origin and age. S. 1927 would amend the Act to include not only those categories covered by H. R. 6516 but also discrimination based on a person's political affiliation, receipt of public assistance benefits, exercise of rights under the Act or other provisions of law and such other classifications as the Board may establish by regulation. In contrast, S. 483 would simply amend the existing law to prohibit discrimination on the basis of an "arbitrary age limit".

Let me begin by stating, as I did before the House Subcommittee on Consumer Affairs on April 22 of this year, that the Board strongly favors the elimination in credit transactions of all discrimination based on factors other than an individual's creditworthiness. Although there is no legal right to receive credit, the Board believes a great deal can be done to assure that credit is made available to equally creditworthy

people on a just and fair basis. The denial of credit based upon a person's membership in a group without reference to that individual's qualifications works to the economic disadvantage of applicants and creditors alike.

It is because we believe that fair and equal access to credit is a matter of great importance that the Board recommends that Congress delay enactment of this legislation until there has been sufficient opportunity to benefit from experience in implementing the regulations under the sex and marital status provisions of the Equal Credit Opportunity Act which goes into effect in October of this year. In the course of our preparation of this regulation we have developed an increased appreciation of the many complexities involved in implementing the requirements of this type of legislation. Based upon our experience to date, we feel that the Equal Credit Opportunity Act should not be extended without a thorough exploration, delineation and resolution of the basic issues present in regulating these areas.

Our experience in drafting regulations to implement the existing law has brought to the surface many problems the solutions to which must be tested in practice before we can confidently apply similar approaches in other areas. Some of the more perplexing questions which have not yet been finally resolved include the extent to which a creditor should be required to consider alimony as ordinary income, the extent to which a non-working spouse should benefit from the credit history of a joint account and the problem of how to provide the consumer with a "clear and meaningful" statement of the reasons for denial. In our efforts to reconcile the statutory goal of equal credit opportunity with the need to preserve the lender's ability to distinguish accurately

the creditworthiness of different applicants we have proposed solutions whose success will not be known until the effects of their actual operation can be measured.

Similarly, even a preliminary look at the prohibition against age discrimination, a major feature of all three bills, discloses particularly complex questions. For example, under the proposed legislation, to what extent will it be permissible to use statistical data in evaluating applicants for credit? Can statistical data relating to age be used in determining creditworthiness in the same way that insurance companies utilize actuarial tables to evaluate insurance risks or should the approach be similar to that in the Equal Employment Opportunity Act */ guidelines which direct that "individuals be considered on the basis of individual capacities, and not on the basis of any characteristics generally attributed to the group" **/ and thereby forbid the reliance on data which reflect the performance of a particular group?

Each of us at the Board is influenced by the realization of how much is at stake in these endeavors. Unless they are carried out in the best possible manner, we may not only fail to gain the positive benefits for our citizens that are so earnestly sought, but we may also reduce the availability of credit and bring discredit upon these and other laudable efforts to dispel bias and prejudice by the reasoned and orderly development of our legal system. An attempt to impose these solutions without sufficient knowledge of their possible ramifications could have the adverse effect of reducing the availability of credit by inflating creditors' costs

*/ Title VII of the 1964 Civil Rights Act, as amended in 1972.

**/ 29 C.F.R. 1604.2 (Equal Employment Opportunity Commission's Guidelines).

and eliminating the smaller lender whose profit margin cannot sustain such costs. Our best hope for achieving the worthy objectives of this proposed legislation will depend upon not only the understanding of the Congress of this fundamental problem but also on our efforts to study and understand the problems as thoroughly as possible, to consult as extensively as we can, and then to draft the regulation as carefully and objectively as we know how.

Accordingly, we would suggest that Congress allow itself more time to continue its study of the problems involved in extending the Equal Credit Opportunity Act to the proposed new categories in order to achieve a thorough analysis of the issues. We also believe that before enlarging the scope of the Equal Credit Opportunity Act, Congress should obtain the benefit of the experience of consumers and creditors under the regulation pertaining to sex and marital status which will be published in final form in the next few months.

If, after reviewing these considerations, the Committee nevertheless decides to proceed with the proposed amendments at this time, the Board of Governors will make the utmost effort to carry out its rule-writing and enforcement responsibilities under the broadened Act in the fairest and the most effective way possible. With that in mind, the Board wishes to emphasize the fact that the presently proposed 6 month rule-writing period is not adequate given the complexity of the issues and the dearth of previous work in these areas of credit regulation.

In accordance with our best estimates, we request that the effective date of the amendments be set at two years rather than six months after enactment. Our objective is a time frame that will permit the Board to discharge its responsibility in a manner that will fully carry out Congress' intent and serve the public interest.

Based upon our experience in writing regulations under the existing Act, and under the Truth in Lending and Fair Credit Billing Acts, the Board is aware that the final version of a regulation of this kind should be adopted at least six months before it becomes effective. The lead time is essential to achieve three basic goals: first, to give the Board time to inform creditors of their new duties and responsibilities under the regulation; second, to give creditors time to revise their procedures, rewrite their forms, and train their people, and third, to allow the Board to educate consumers as to their rights under the amended Act. For example, a minimum lead time of several months is needed simply to print the new application forms in the quantities required.

Thus a period of two years only provides 18 months in actuality for the rulewriting process itself. We have constructed a timetable, and attached it to this testimony, which explains in detail what must be done during the 18 months needed for the actual drafting and adoption of a regulation of the quality we believe Congress wants and the public interest requires.

I would now like to comment upon specific provisions of the three bills. With regard to S. 483, the only point I would like to raise concerns the use of the word "arbitrary" to modify the term "age limit." The Board has concurred with the position expressed by Congress in the

language of the current law relating to sex and marital status --that it would be unwise to place any qualifying language in the statement of the Act's basic prohibition. The addition of the term "arbitrary," while appearing to modify the class protected by the Act, in fact, gives little, if any, guidance to the Board as to what is intended. More significant, it may be inconsistent with the extensive body of civil rights law which defines the word "discriminate" and establishes the legal standards of scrutiny to be used in determining whether conduct is discriminatory.*/ If Congress wishes to qualify the coverage of the amendment in the area of age, it is recommended that such qualifications be spelled out with particularity.

Let me turn now to a second bill regarding Equal Credit Opportunity -- S. 1927. Section 701(a) of this bill would establish three specific categories of prohibited discrimination which are not included in H. R. 6516. These are the categories of political affiliation, receipt of public assistance benefits, and exercise of rights under the Act or other provision of law. With regard to the inclusion of "political affiliation" as a category of prohibited discrimination, we suggest that, since we are not aware of any evidence of such discrimination, this would appear to be an area in which further inquiry on the Committee's part may be advisable.

In contrast evidence has been presented regarding discrimination on the basis of an applicant's receipt of public assistance benefits. Surveys reported by the National Commission on Consumer Finance suggest that

*/ See, e.g. *Griggs v. Duke Power Co.*, 401 U.S. 424, 429-30 (1971); *Albermarle Paper Co. v. Moody*, _____ U.S. _____, Slip Opinion at 10-11 (June 25, 1975).

the problem is significant. */ We would agree that the receipt of public assistance, be it Aid to Dependent Children, disability or Social Security benefits, should not by itself disqualify one for credit. In all cases the essential determinants of a person's qualifications for credit are the ability and willingness to repay. Since credit is often extended to cover the most basic purchases, including shelter, clothing, and furniture, the credit granting process should offer every applicant the opportunity to demonstrate his or her individual merits.

Section 701(a)(5) of the bill would prohibit discrimination on the basis of "exercise of rights under this act or other provisions of law." We have no difficulty with the first part of that category but the term "or other provisions of law" would bring within the act's prohibition the exercise of the entire spectrum of other legal rights, some of which a creditor might justifiably consider in determining creditworthiness. The most obvious case is the exercise of rights under the bankruptcy law. We believe a discharge in bankruptcy to be a valid consideration in a determination of creditworthiness and one that should not be prohibited. We suggest that this category of prohibition be revised to include only "exercise of rights under this Act."

Sections 701(b) of S. 1927 and 701(d) of H.R. 6516, provide, in effect, that the consideration of an applicant's age, when used for the purpose of applying criteria favoring applicants in a particular age category, shall not constitute discrimination. These provisions require some revision to clarify their scope and intent. According to the

*/ "Consumer Credit in the United States, "Report of the National Commission on Consumer Finance, 155-160 (December, 1972).

House Committee report on H. R. 6516 and the comments accompanying the introduction of S. 1927, the provisions were intended to permit the use of age information when carrying out affirmative action programs designed to benefit a particular age category. It would be preferable if these provisions described with specificity which age categories are deemed to be in need of such protection, and then explicitly authorized the Board to implement these objectives by regulation. As the provision now reads, it creates a loophole by making it possible for a creditor who discriminated against one age category, to raise as a defense the argument that its policy was designed to favor another age category.

Section 701(d) of S. 1927 would require creditors to furnish rejected applicants with a notice of the reasons for denial or termination of credit. As the Committee may be aware, the proposed regulation issued by the Board under the existing act contains a similar provision which would require notice of reasons for denial only when requested by an applicant. The Board is still considering this entire question. Its present feeling is that requiring the notice to be given only where requested would accomplish the purposes of the requirement without putting the creditor to the unnecessary expense of providing a written statement in all instances of denial. The Board believes that the existing law provides the necessary authority for a provision of this nature, however, if Congress desires to include the provision in the amendments to the Act, the Board would welcome this explicit statement of its authority and would suggest that Congress consider the modified version contained in the proposed regulation.



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I would now like to address the two legislative proposals, S. 1900 and S. 1961, dealing with consumer leasing which the Subcommittee is considering. 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 the two bills.

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 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 S. 1961 and one section of S. 1900 that we regard as highly important. The first is § 183, a sectional reference common to both bills, which sets a limitation on a consumer lessee's liability. This section of the two bills 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.

Section 183 of S. 1961 sets the lessee's contingent liability as the lesser of twice the average monthly rental payment or 10 per cent of the total rental payments under the lease. The comparable provision in S. 1900 states that the lessee's contingent liability would be limited to three times the monthly rental payment or a larger amount agreed upon by the lessor and lessee. Both bills provide an exception to the limit placed on lessee liability in the case of damage beyond normal wear and tear to the leased product or in the case of lessee delinquency.

The provisions of both bills are designed to assure that the lessee is notified in advance of the extent of his maximum contract liability under the lease. By incorporating a monthly payment factor or a percentage of total payments into the computation of this maximum end-term figure, both bills seek to assure that the lessor will price the rental instalments of the leased goods 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.

The Board supports the purpose of both of these protective features. However, as the Board stated in its 1974 Annual Report, it is not committed to any specific liability formula. The three-month formula of S. 1900 or the 10 per cent alternative in S. 1961 may both be quite adequate. The Board would hope, however, that whatever formula may be chosen will reflect industry experience in accurately setting depreciated values.

Some, but not all, members of the Board have concern over the provision in S. 1900, which allows for the substitution of a larger amount agreed to by the lessee and lessor. Their concern is with the likely disparity in bargaining power between lessee and lessor and with the possibility that such a larger amount might be offered in a pre-printed form contract on a "take-it or leave-it" basis. They believe, moreover, that some limitation tied to instalment payments is highly desirable, because of its ability to assure that the leased product will be fairly priced to cover anticipated depreciation.

The second provision on which I would like to comment is § 6 of S. 1961. 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 S. 1961 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, and an effort must be made to educate consumers on the legislation. 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, as § 5 of S. 1900 would provide, before this Act is to become effective.

In closing I would like to commend this Committee for the action taken in the area of consumer leasing. This new and expanding alternative to credit purchases, we feel, merits careful attention, and we are hopeful 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. With regard to the Equal Credit amendments, the Board supports the purposes of the legislation but believes that further inquiry and analysis are needed to devise the most suitable methods of serving;

these purposes. We believe the prudent course would be to draw upon the experience which will be gained after the existing law covering sex and marital status has been in effect for a reasonable time, and to defer extensions of the coverage of the Act until such experience is available. I will be pleased to respond to any of your questions.

Federal Reserve memorandum on
estimated working schedule
for developing a
regulation under
H. R. 6516

(Amendments to the Equal Credit Opportunity Act)

In order to meet the standards of public information established by the Congress in the Administrative Procedure Act, to afford an adequate opportunity for identification and exploration of problem areas, and to facilitate public participation in the rulewriting process, the following procedures are necessary. Estimated times are given for each.

Contact with affected persons and groups and identification of problems: 5 to 6 months. Contact must be made with consumer groups and with representatives of creditor interests, in order that these groups can meet with the staff to educate it as to the problems that are likely to arise in implementing the Act. While much work of this kind has already been done under the present provisions relating to sex and marital status, the new categories will affect consumer groups that have not yet been heard from and will undoubtedly raise problems on the creditor side that have not yet served as the focus of their attention.

In order to comment and to educate the Board's staff in a useful way, it is necessary for those who are affected to have some time in which to study the legislation and consult with their associates. It has been our experience that five to six months should be afforded for this kind of study and consultation, and for the meetings with

staff that follow. While informal consultation of this kind of course continues throughout the rulewriting process, it has been the Board's experience that this initial period provides an essential foundation for building a sound regulation.

Constructing the draft regulation: 5 months. As the initial period draws to a close, staff is in a position to begin actual work of drafting. This work involves the most careful analysis of every word and phrase that is to go into the regulation. There will also be a need for extensive consultation with staffs of the Reserve Banks and of other agencies having enforcement responsibility under the Act. The proposed regulation under the Equal Credit Opportunity Act which the Board released for public comment on April 23, for example, went through eight complete preliminary drafts before it was ready to be considered by the Board of Governors. That regulation was drafted under a very intensive time constraint, because of the deadline imposed by the Act. The new amendments would raise questions in a number of vital areas such as age where there has not been the initial background provided by the hearings on the bills leading up to the present Act, and it is estimated that about three and a half months would be required for completion of a staff draft and a further month and a half for study and revision by the Board itself.

Public comment after publication in the Federal Register: 4 months. At this point, the draft would be ready to be published for public comment. It has been the Board's experience that the actual

language of a proposed regulation invariably gives rise to unforeseen but important comments and objections from all sides. At least a hundred and twenty days more should be afforded in order to give adequate opportunity for affected consumer and creditor groups to study this language and realize its import, as well as for the agencies having enforcement responsibilities under the statute to react to changes made from preliminary drafts in response to their, and other, comments.

Public hearings and filing of supplementary views: 1 1/2 months.

The Board has scheduled public hearings to be held on its proposed regulation relating to sex and marital status, so that there can be full public participation in the rulewriting process. A public hearing would appear even more essential under the proposed amendments. Another six weeks should be provided, therefore, to allow for review of the transcript and for the filing of supplementary views and comments.

Final revisions: 3 months. The work by the Board and its staff of revising the proposed rule in the light of written comments received, oral presentations made at a hearing, and supplementary views cannot be accomplished satisfactorily in less than a further ninety days. Very significant revisions may have to be made at this stage and it may be necessary to go back and consult further with consumers and creditors as to the meaning and suitable implementation of suggestions they have made. It is not until these final adjustments have been made is a final rule ready to be promulgated.

It thus appears that the best estimate of a working schedule to complete and publish a regulation implementing H.R. 6516 will total at least eighteen months.

It is only after promulgation of a final rule that consumers and creditors alike receive definite word as to what the new regulation will provide. As stated in the covering letter, six months will provide only a minimum of time for the public to become informed about a matter as critical as these rules would be to the welfare of very many consumers, and for creditors to prepare to comply with such rules. It should be emphasized that the estimates given above are minimums and are based upon actual experience for each phase of the rulewriting process.

The above schedule allows very little time for economic studies to illuminate questions such as the validity of statistically-based conclusions as to the relationship between age and credit-worthiness (some creditors it is understood, have found this particular relationship to be affirmative at all points along the scale for persons in their middle fifties and beyond). In order to be taken into consideration in the rulewriting process, such studies would probably have to be completed within the first six or eight months. Nor do they allow time for contingencies that might arise requiring republication of a revised rule for comment. Nevertheless, with an two year lead time, the Board could feel more confident of doing a job that would justify the confidence the Congress has shown in it.

In order to allow eighteen months for the rulewriting process, plus a six-month adjustment period after the regulation is adopted in final form, section 708 of the Equal Opportunity Act, as redesignated by section 5 of H.R. 6516, should be amended by inserting ", except that the amendments made by the Equal Credit Opportunity Act Amendments of 1975 shall take effect two years after the date of its enactment" immediately before the period at the end thereof.