

For release on delivery

Statement by

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Member, Board of Governors of the Federal Reserve System

before the

Subcommittee on Commerce, Consumer, and Monetary Affairs

of the

Committee on Government Operations

U.S. House of Representatives

September 16, 1976

I welcome the opportunity to testify today before the Subcommittee on Commerce, Consumer, and Monetary Affairs regarding the issue of enforcement of the Truth in Lending Act. The Board appreciates your interest in our enforcement efforts. As you are aware, the Board's staff and members of the Subcommittee staff have met on a number of occasions during the last few weeks in preparation for these hearings. I would like to begin by presenting an overview of the Federal Reserve System's previous enforcement effort of Truth in Lending and its new plan for enforcement of all consumer laws and regulations in the future.

The Federal Reserve System has a dual responsibility under the Truth in Lending Act. First, the Board of Governors has the responsibility to issue regulations to implement the Act. To this end, the Board issued Regulation Z in 1969. These regulations apply to all persons and entities who regularly extend consumer credit. This task also includes the issuance of numerous amendments and interpretations designed to resolve uncertainties as to the impact of the legislation. The staff has also issued more than 1,100 public position letters regarding the Regulation.

While the Board's emphasis has been on rulewriting, the Federal Reserve System also has responsibility to enforce the Regulation among some 1,050 State chartered banks that are members of the System. This enforcement responsibility is carried out in the first instance by the 12 Federal Reserve Banks, which maintain a force of examining personnel who perform annual examinations of the State member banks.

Compliance by State member banks is monitored through a review of each bank's formal policies and procedures, as well as an examination of the actual practices followed. To illustrate, compliance with Truth in Lending requirements is verified through review of the bank's policies and procedures in granting direct and indirect consumer loans, the disclosure forms used in connection with those loans, and copies of its advertising. Violations are called to the attention of management with a view toward informing the bank of the law's requirements, obtaining correction, and getting the bank to adopt measures to prevent future occurrences. Violations and the bank management's plan for correction are also noted on a separate page in the Examination Report (page 5(1)), a sample copy of which is attached. Depending upon the nature and seriousness of the violation, the Federal Reserve Bank, in transmitting a copy of the Examination Report to the bank, may highlight the violation and ask for management's response by a given date as to the action taken to prevent recurrences of the violation. Of course, during any subsequent examination, a determination is made as to whether violations previously cited have been corrected.

Enforcement of the Truth in Lending Act is also carried out through the investigation of consumer complaints concerning the State member banks. During the first half of 1976, the 12 Federal Reserve Banks handled 1,131 complaints. Two-thirds of these complaints were investigated by the Reserve Banks, as they related to State member banks.

The remaining one-third involved creditors not under the System's direct supervision and were forwarded to the appropriate enforcement agency. Where violations of the Act have been found, the banks are told to correct them. The Board is made aware of compliance deficiencies at State member banks by the Reserve Banks which prepare a quarterly report for the Board summarizing the consumer complaint activity.

The Board and the Federal Reserve Banks have taken a number of steps to provide examiners with the training and investigatory tools needed to perform effective Truth in Lending compliance reviews. Before Regulation Z became effective (July 1, 1969), members of the Board's staff conducted seminars for examiners at the Federal Reserve Banks explaining the requirements of the Regulation. This program was repeated in 1973. In addition, the Board prepared an extensive examination manual and checklist on Truth in Lending designed to be used by examiners for enforcing Regulation Z. In connection with the Fair Credit Billing Act, the Board conducted intensive reviews of the new requirements for both the key examination personnel of the Reserve Banks and for persons from the other Federal enforcement agencies. In addition, the Federal Reserve Banks have held numerous training sessions for examiners, particularly newly appointed examiners.

Each System examiner attends our Assistant Examiner and Examiner Schools which devote time to explaining Regulation Z and to training examiners to determine whether State member banks

are in compliance with the law. It should be noted that some examiners from State banking departments also attend the System's schools.

Since enactment of the Truth in Lending Act in 1968, the Board has conducted an extensive consumer and creditor educational program relating to the Act and Regulation Z. Education to assist the consumer in understanding the information and other benefits that the legislation is intended to provide is regarded as very important. Newspaper articles, interviews, and radio appearances continue to be used in our efforts to acquaint the general public with the Truth in Lending Act. Consumer affairs liaison officers and staff at the Federal Reserve Banks also conduct frequent meetings and seminars for creditor and consumer groups.

The Board believes that education of creditors is an important device in preventing noncompliance problems. As an example of this educational program, following the passage of the recent Fair Credit Billing Amendments to the Act and the Board's issuance of implementing amendments to Regulation Z, the Board's staff participated in numerous meetings and seminars for the purpose of explaining to creditors the new provisions and requirements. Approximately 6,200 creditors attended these meetings which were held throughout the United States during 1975.

The System has also distributed more than two million copies of a pamphlet that contains both the Act and Regulation Z, as well as questions and answers concerning compliance matters. In addition, more than three and one half million copies of a leaflet explaining the basics of Truth in Lending to consumers have been distributed, including

more than a half-million copies of a Spanish language version. Our staff is developing similar pamphlets on the provisions of the Fair Credit Billing and Equal Credit Opportunity Acts.

Up to this point, the System has been able to utilize the standard bank examination process to determine State-member bank compliance with Truth in Lending. However, with the growth of consumer credit legislation, we recognize the need for expanding our enforcement efforts. These new consumer-oriented laws, all of which have been enacted during the past two years, include the Fair Credit Billing Act, Equal Credit Opportunity Act, Consumer Leasing Act, Home Mortgage Disclosure Act, Real Estate Settlement Procedures Act, and the provisions of the Federal Trade Commission Improvement Act relating to unfair and deceptive acts and practices by banks. In recognition of this expansion, the Board has recently approved the following program:

1. The establishment of a special consumer compliance examination school to be held in Washington, D.C. This school will acquaint examiners more fully with the requirements of the many consumer credit regulations and the methods for enforcing them. The first school is scheduled to begin September 27, 1976 and additional schools will be scheduled thereafter. I have attached a copy of the agenda to my written statement.

2. Institution of an intensive educational and advisory service in each Federal Reserve Bank to assist State member banks

in their efforts toward compliance. Each Reserve Bank is establishing a team of specialists to assist State member banks in complying with the Board's consumer regulations.

3. Special examination of State member banks will shortly be initiated by bank examiners who have received special training in the consumer credit regulations. These examinations ordinarily would be conducted and scheduled to coincide with the regular commercial examinations, but they may, at times, be scheduled separately. After the first 24 months of the program (December 31, 1978), a thorough evaluation of the program would be conducted.

4. The immediate formation of a special Task Force, comprised of representatives from the Board and the examining departments of the Federal Reserve Banks, to study and promptly report to the Board on the following issues:

a. The implementation of specific examination procedures to carry out consumer regulation compliance.

b. The appropriate sample size needed to measure a bank's compliance with the regulations, e.g., the quantity of disclosure forms, finance charge computations, and annual percentage rate calculations to be reviewed.

c. The determination of what steps should be taken when violations are discovered.

d. The expansion of the System's Public Education Program to inform creditors and consumers about the new consumer legislation.

5. The System plans to involve the new Consumer Advisory Council to the fullest extent possible in bringing to its attention Truth in Lending abuses.

The efforts outlined above should result in an even more effective enforcement program. In this connection, the Comptroller of the Currency and the Federal Deposit Insurance Corporation have also been evaluating existing procedures. During the last three months, Board staff has been working with the staffs of these two agencies toward developing a uniform approach to examinations of commercial banks. To date, the product of this effort includes development of examination manuals, report pages, training manuals, and interagency instructors for the agencies' consumer regulations training schools.

The Subcommittee also requested that the Board present its position on the merits of three issues relating to noncompliance disclosure. These issues are:

1. Notification to individual borrowers that their loan transaction may contain a violation of some section of Truth in Lending regulations;
2. Disclosure through the media of the degree of individual bank noncompliance with Truth in Lending regulations; and
3. The relationship of disclosure to the self-enforcing nature of the Truth in Lending Act.

The Board believes it would be premature to take positions on these issues prior to receipt of the Task Force report mentioned earlier. These issues involve numerous and difficult considerations which the Board believes need further analysis and experience before

being decided. I can assure you, however, that the Board will give these matters their deserved attention, and I would be happy to report to you when the Board finally adopts its positions. However, in order to be as helpful to this Subcommittee as possible, I would like to now raise some of our primary concerns with the points you mention.

As the Board has repeatedly indicated both in testimony and reports to the Congress, the majority of violations of the Truth in Lending Act are purely technical in nature. Given the highly complex nature of the Regulation, technical violations will occur due to unintentional and inevitable human error. An example of such an error would be the failure to denote a prepaid finance charge as such (although it is disclosed as a finance charge). In most violations, the customer is neither overcharged nor misled. It may be unwarranted to notify borrowers and/or the media that a bank has committed such technical violations. Such a procedure may unduly encourage a proliferation of civil actions to be brought against the offending bank even when only technical violations have occurred.

Much of the present complexity of the Act and Regulation Z reflects the impact of the civil liability considerations. The threat of severe penalties for relatively minor technical violations has led many creditors to seek greater certainty by requesting official Board amendments and interpretations, which further complicate the Regulation. Although private causes of action provide an important enforcement tool for the Act, the Board believes that Congress should carefully review the present civil liability provisions to determine



whether modification of them might reduce needless litigation and the resulting regulatory complications.

The Board has taken one action and is considering another that may assist in reducing unnecessary litigation. The Board has adopted procedures implementing the provisions of Public Laws 94-222 and 94-239, which provide a defense for creditors relying upon letters issued by duly authorized officials of the Board in connection with Regulations B and Z. In addition, the Board is considering the development of standardized Truth in Lending disclosure forms, or portions of forms, on which creditors could rely in complying with the Act. It is hoped that these forms will prove especially beneficial to those creditors, such as small retailers, who do not have access to, or cannot afford, specialized legal counsel to design their own forms.

While these measures should reduce the present volume of litigation and help alleviate confusion resulting from the complexity of the Act and the Regulation, the Board has asked that Congress also study the possibility of limiting the penalty provisions of the statute to violations that actually interfere with the consumer's ability to make meaningful comparisons of credit terms. Only a limited number of terms seem to be genuinely helpful in this regard. These probably include the annual percentage rate, the finance charge, the amount financed, and the repayment schedule. Perhaps only material misstatements of these terms should be brought to the attention of consumers and civil liability only attach where such misstatements have occurred. This would leave technical violations to be dealt

with by administrative remedies. Under present law, a creditor may be penalized for purely technical violations of which the consumer may have been unaware at the time and which in no way entered into the decision to accept or reject the credit terms offered. This situation lends itself to abuse and has overburdened some courts with Truth in Lending litigation.

From 1972 through September, 1975, approximately 6,100 suits have been filed in Federal District courts alleging violations of the Truth in Lending Act. This indicates to some degree that the self-enforcement mechanism within the Act is being exercised. Many of these suits, however, were the result of technical violations being committed and were not initiated solely on the basis of a violation of the Act, but as a part of a bankruptcy or other collection proceeding; thus, it would appear that the thrust of civil actions brought under the Act has not been directed to improving those pertinent disclosure items which assist consumers in shopping for credit. The Board shares the concern of Congress that these issues concerning compliance with the Truth in Lending Act and other consumer-oriented regulations must be resolved.

The Board sincerely appreciates the opportunity to come before this Committee and to be of assistance to the Committee in its oversight responsibilities. I would be more than glad to answer any questions you may have. Thank you Mr. Chairman.

OSCA
School for Examiners
First Session
Curriculum

Week of September 27, 1976

| Period | Time | Monday September 27 | Tuesday September 28 | Wednesday September 29 | Thursday September 30 | Friday October 1 |
|--------|----------------|---|---|---|--|---|
| 1 | 9:00 9:55 | Introductory comments Gov. Jackson Janet Hart | Fair Credit Billing Glenn Loney | Municipal Securities Dealer Bank Activities * N. Shupeck | ECOA Case Study Committee Report | Examiners' Responsibilities; FRBank Authority; Enforcement Actions |
| 2 | 10:10 11:00 | Reg. B (present rules) N. Butler | Fair Credit Practices Examination Procedures E. Schmelzer and B. Silver | MSD (cont.) * Examination Proc. M. Schoenfeld | ECOA Case Study (cont.) include class discussion | Critique |
| 3 | 11:05 12:00 | Reg. B (cont.) and Fair Credit Reporting A. Geary | Reg. B. (proposed) and Title VIII N. Butler | Reg. U * R. Lacoste | 11:05 - 11:35 Reg. Q - A. Raiken 11:36 - 12:00 Flood Ins. - R. Insley | Summary Future Prospects Presentation of Certificates J. Kluckman |
| 4 | 1:00 1:55 | Truth in Lending E. Schmelzer | Reg. C R. Plows | Fair Credit Practices Case Study Committee Report | RESPA and Unfair and Deceptive Practices M. Medvin | * FCP Case Study Group consisting of students not involved in SCR programs will meet in separate classroom. |
| 5 | 2:00 2:55 | TIL (cont.) M. Stewart | Panel - ECOA staff Examination techniques for discovery of discrimination | FCP Case Study (cont.) include class discussion | Compliance Reporting including: | ** ECOA Case Study Group consisting of students not involved in SCR programs will meet in separate classroom. |
| 6 | 3:10 4:00 | Consumer Education _ C. Aldrich _ Consumer Complaint Procedures-K. Casey | | Reg. G ** M. Schoenfeld | Uniform Compliance Report; | |
| 7 | 4:05 5:00 | Fair Credit Reporting M. English | Consumer Leasing L. Barr | Regs. T and X ** R. Lacoste | Reporting Standards; Commonly Found Violations | |

Examination as of the close of business

District Number

Total Deposits \$

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(Name of bank)

(City)

(County)

(State)

REGULATION Z—TRUTH IN LENDING

1. Were test checks made of the bank's forms and procedures for disclosure? If any irregularities were disclosed, discuss in detail and indicate management's plans for correction.

2. Has bank established effective procedures to detect defects in disclosures on dealer paper which it proposes to acquire? If not, or if there are defects, discuss in detail and indicate management plans to correct existing procedures or establish new ones.

3. Were test checks made of the bank's advertising? If any irregularities were disclosed, discuss in detail and indicate proposed plans to prevent future occurrences.

4. If it appears that reservation rights are not being properly observed on both direct and indirect paper, discuss in detail.