

Statement by

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Board of Governors of the Federal Reserve System

before the

Consumer Affairs Subcommittee
of the Committee on Banking, Finance and Urban Affairs

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Mr. Chairman, I appreciate this opportunity to participate on behalf of the Board of Governors in your subcommittee's hearings on the current status of consumer credit laws. While it supports the basic public purpose of consumer credit legislation, the Board has become increasingly concerned about the degree of complexity and overlap of existing laws and hopes the situation can be clarified and simplified. It is small wonder that the members of Congress and the Board have received a substantial quantity of complaints, particularly from small creditors, stating that they have difficulty understanding and complying with all of the laws. Some responsible observers are now questioning whether the existing regulatory framework is providing benefits to the public commensurate to its costs.

To give perspective to the issues we will raise, I would like first to provide a brief review of consumer credit legislation in our country. I will also report generally on the Board's experience to date as the principal agency charged with writing regulations to implement Federal legislation in this field. Finally, I would like to suggest some matters your Committee may want to consider.

With rare exceptions, consumer credit regulatory legislation prior to 1968 was enacted by the various States rather than the Federal government. Even then the laws were complicated. Most States have long had laws setting a ceiling on the price for loans to consumers. To this basic legislation, most States over time added a multiple layering of special conditions and rules.

Your own home State of Illinois, Mr. Chairman, is a typical example. I am told that virtually no consumer credit transactions take place under the Illinois basic interest ceiling law. Instead, they occur under many different laws. For example, the Retail Installment Sales Act governs the credit sale of goods other than motor vehicles, which fall under the Motor Vehicle Retail Installment Sales Act. There are six separate, but partially overlapping, laws in Illinois governing consumer loans. Each of these different laws tends to have its own set of special requirements for contract provisions, notices, administration, advertising, insurance, disclosure and related matters. Thus, even without Federal legislation, the statutory situation was complex.

The Federal government entered the consumer credit field initially through various credit programs concerning home mortgage credit, insurance or guaranties, and farm credit. The Board of Governors first began to regulate consumer credit practices in 1968 with the passage of the Federal Consumer Credit Protection Act, commonly known as Truth in Lending. The Act directed the Board to write implementing regulations which became Regulation Z.

Since 1968, the Congress has passed seven major amendments to the Consumer Credit Protection Act, as well as three separate disclosure statutes involving credit terms. Significantly, eight of these statutory changes have been enacted since October 1974 -- a period of less than 28 months -- and nine of the ten laws have required implementing regulations.

Specifically, the statutory changes include in chronological order:

1. The Fair Credit Reporting Act (1970)
2. The Credit Card Amendments to Truth in Lending (1970)
3. Technical Amendments to Truth in Lending (1974)
4. The Fair Credit Billing Act (1974)
5. The Equal Credit Opportunity Act (1974)
6. The Real Estate Settlement Procedures Act (1974)
7. The Federal Trade Commission Improvement Act (1975)
8. The Home Mortgage Disclosure Act (1976)
9. The Consumer Leasing Act (1976)
10. Amendments to the Equal Credit Opportunity Act (1976)

At the direction of Congress, the Federal Reserve has been involved in developing written regulations under all but one of the Acts. The Board also issues Official interpretations of its regulations. Recently, Congress empowered the Board to authorize Official Staff Interpretations upon which creditors could rely without fear of civil liability, and the staff has begun issuing these interpretations. In addition, our staff has historically answered informal inquiries about the regulations. Although these staff interpretations do not have the force and effect of law, most conscientious creditors react to them as if they did. Finally, the courts have been offering further interpretations of the Acts, regulations, and interpretations. At this time, there are several hundred reported decisions on Truth in Lending alone.

In addition to implementing relatively specific statutory provisions, Congress has directed the Federal Trade Commission and the Board to issue rules and regulations defining and outlawing unfair or deceptive trade practices under the 1975 FTC Improvement Act. Currently pending under that authority are three detailed Trade Regulation Rules proposed by the Commission: the Creditor Practices Rule, dealing with collateral and collection practices; the creditor amendment to the Rule Preserving Consumers' Claims and Defenses (the so-called Holder Rule); and the Used Motor Vehicle Rule.

In summary, we now have a system which layers State laws, State regulations, Federal laws and regulations, staff interpretations, and State and Federal court decisions.

If one had the advantage of knowing in advance that the governmental control of consumer credit would develop in the form I have outlined, two conclusions could readily have been drawn. First, State and Federal law would not fit very well together and, therefore, would produce substantial conflicts and difficulties. The second would be that the entire consumer credit regulation framework would be complex and difficult to understand, administer, and comply with.

The relationship between State and Federal law is complicated by provisions in many of the Act's the Board administers relating to preemption or exemption of State law. When should a State law be preempted by a Federal law? When should transactions within a State be exempted from a Federal law? Further confusion arises from the fact that the various statutes set different standards applicable to different areas of law. In addition, the problem is more complex because the subject matter and purposes of these statutes differ widely. Let me give you some examples of the preemption/exemption problem.

The original Truth in Lending Act set a rather simple standard under which those State disclosure laws found to be "inconsistent" with the Federal law were preempted. Likewise, the Truth in Lending standard for determining when a State should be exempt from Chapter II of the Truth in Lending Act is that the State law must be "substantially similar" to the Federal law.

The Fair Credit Billing Act carried the standard for Federal preemption of State law one step further. As under Truth in Lending, a State's law is preempted to the extent that it is found inconsistent. However, the Board may not find that the State law is inconsistent to the extent that it provides greater protection to the consumer. This additional step has caused considerable conceptual difficulty. How should the laws be compared - in their entireties, or section by section? Defining and applying the standard raises still more problems. For example, New York requires that a billing inquiry be sent by registered mail; the Federal law does not. It could be argued that the New York law is more protective

since it provides for better proof that the customer sent the inquiry. Alternatively, one could argue that it is less protective and thus inconsistent because of the additional burden placed upon the consumer to register the letter and pay the increased postage costs.

The Consumer Leasing Act adds a further complication. Under it, to be protected from preemption, an otherwise inconsistent State law must provide not only greater protection, but greater benefit to the consumer.

While the preemption/exemption standards under the Equal Credit Opportunity Act are similar to the Truth in Lending Act, the subject matter of the Act--adverse discrimination--is so different as to make the experience gained under Truth in Lending of limited value to the Board. Determining what is inconsistent may not be too difficult. For example, Ohio prohibits discrimination on the basis of age. The Federal law permits the use of age in a credit scoring system so long as the age of an elderly applicant is not assigned a negative factor. The Ohio law is in direct conflict, and thus is preempted as of March 23, 1977.

Determining what is more protective in the context of an anti-discrimination law is much trickier. Several years ago civil rights groups insisted that questions as to an applicant's race should not be permitted. Today, they take the position that not only should race be asked, but that it should be recorded for enforcement purposes.

Which is more protective? Similar questions arise with respect to recordkeeping as to sex, marital status, and age.

Other State statutes may be affected as well. For example, in Alabama a person gains legal capacity to contract at the age of 21-- unless that person is married, in which case the legal age is 18. Can a creditor take that statute into account in granting credit? If the creditor does so, is the creditor discriminating on the basis of marital status? If that is illegal discrimination, then the Alabama law may be preempted. But if the Alabama statute is preempted, does that mean that an unmarried 18-year-old can enter into a binding contract or that a married 18-year-old cannot?

The intricacies of the State-Federal relationship is not the only source of complexity. The economic practices and customs of every facet of American society are more varied and divergent than any law or regulation can anticipate. A rule designed to meet one need often produces unexpected consequences in another situation. The extensive regulations that result are a direct product of the dynamic credit system to which they apply.

Given these dynamics and this complexity, given the sheer quantity of State and Federal statutes, regulations, interpretations and judicial decisions, and given the fact that they fit together so badly, it is not surprising that the loan officer of a small bank - charged with the varied responsibilities of: making installment loans, buying dealer paper, over-seeing a credit card operation, making home mortgage loans, extending construction credit, arranging for credit insurance, and so forth - is hard pressed to comply.

The Board of Governors is taking several actions in an effort to be responsive to some of the obvious needs that I have outlined. We have established a Consumer Advisory Council in accordance with the provisions of the 1976 statute. The Council met in November, with the next meeting scheduled for March 10. These meetings are open to the public. Membership of the Council is broadly representative of the interests of consumers and creditors alike. The Council is establishing study groups which plan to make on-site investigations of large and small creditors to better understand the ramifications of consumer credit laws regarding the credit granting process.

The Board also has contracted with the Survey Research Center of the University of Michigan to undertake a special consumer survey intended to provide much needed information on the consumer's relationship to credit. Several other Federal agencies are joining us in this survey effort. It is our hope that the survey will enable us to understand better the various circumstances in which consumers use credit, to evaluate consumers' perceptions of and interest in the benefits that consumer credit laws provide, and to gain insight as to how regulations can be more responsive to the consumer's needs.

In order to assist creditors, particularly small ones, in their efforts at compliance, the Board is expanding its issuance of approved forms which may be used by creditors without fear of violating technical provisions of the statutes or regulations. We are also continuing to issue binding staff interpretations where necessary. Under the statute, which your Committee authorized, creditors relying on these staff interpretations are protected from the penalties of the law should the courts later determine that such interpretations are invalid.

Members of the Board's staff are engaged in a review of present consumer credit regulations for the purpose of developing proposals to make them easier to understand and comply with.

The Board recently promulgated a new Regulation AA to encourage consumers to inform the System of their credit problems and to provide a better basis for action on the part of the Board in response to these consumer complaints.

Finally, as the supervisor for State member banks, we are substantially expanding our compliance and enforcement activities under the various consumer credit statutes. Our experience in this process will enable us to better understand the impact of our regulations issued under consumer credit statutes.

The Board of Governors made a number of specific legislative recommendations in its 1975 year-end report. Among these was a suggestion that the Congress re-examine the Truth in Lending Act's provisions on the issuance of credit cards, and on cardholder liability in the event of unauthorized use, in light of recent developments in the electronic funds transfer field. Specifically, the Board recommended that Congress extend the \$50 limit on consumer liability to non-credit funds transfer cards. In addition, the Board suggested that the Congress reconsider the need for the existing ban on the unsolicited issuance of credit cards. In the Board's view, the present limitation on liability has itself adequately curtailed the profligate issuance of credit cards prevalent in the mid-1960's, while the Act's provisions restricting credit card issuance have lessened competition in the credit card field. We sincerely hope that your Committee may find time to consider these proposals, as well as the other recommendations in the Board's report.

In our view, substantial benefits to the public could be realized if there were to be a determination as to the proper role of the States versus the Federal government in consumer credit protection statutes. Such a determination should cover not only which law might govern or which might be preemptive of the other, but also such questions as which supervisor - State or Federal - is charged with policing organizations operating within the States. As the larger creditors conduct their affairs over wide geographical areas, there is more urgent need to understand which benefits could accrue to the public from uniformity of regulations and procedures. Such benefits would then need to be weighed against our historic rights of the citizens of the several States to pass laws uniquely applicable to those who reside therein.

The effort to simplify consumer credit laws and regulations is a complex one in and of itself. While the need warrants your Committee's consideration, it will not be an easy one to accomplish. Even some creditors would argue against any attempt to simplify. Some feel that they have now mastered the complexities of the regulations and that any attempts to simplify will result only in a new set of requirements which will require substantial retraining and produce another period of uncertainty.

There are many who feel that complexity of the Truth in Lending statute is a by-product of the penalties which the Act imposes. The original concept of private enforcement of this statute has obvious imperfections. We believe there would be substantial potential for simplification if the penalties provided as a result of private suit or class action were restricted to instances of substantive violations that impair the consumer's capacity to

comparison shop for credit. Technical violations of the statute might well be limited to administrative supervisory enforcement.

Mr. Chairman, I hope these comments have been responsive to the Committee's needs and will be pleased to respond to any questions you may have.