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Statement by

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Board of Governors of the Federal Reserve System

before the

**Commerce, Consumer, and Monetary Affairs Subcommittee
of the Committee on Government Operations**

United States House of Representatives

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It is a pleasure for me to make my first appearance before this Subcommittee. I look forward to working with you on our common problems and objectives.

The purpose of today's meeting is to review supervision of bank advertising practices by the Federal financial regulatory agencies. The Board's testimony was solicited on issues dealing with merchandise promotions, and misleading or deceptive advertisements that fail to disclose relevant information.

The Board has been involved under its statutory responsibilities with the area of bank advertising for many years. Regulation Q (Interest on Deposits) and Regulation Z (Truth in Lending) contain a number of provisions relating to bank advertising. These provisions are monitored and enforced by the Board through Consumer Compliance Examinations conducted at all State member banks by System examiners. In addition, the Board has established procedures in Regulation AA to act on individual complaints received by the Board or the Reserve Banks.

With regard to merchandise promotions, the Board has taken the position that the question whether a bank should be permitted to engage in either the sale or give-away of merchandise is primarily the responsibility of the institution's chartering authority. The Board's principal concern with respect to such promotions has been to determine whether they result in the payment of additional interest to depositors in violation of the Board's rules and limitations on the payment of interest on deposits.

Although the Board has not adopted formal regulations expressly pertaining to merchandise promotions (and is not considering such regulations

at the present time), it has stated in a Published Interpretation that a premium given to a depositor (whether in cash or in merchandise) will not be considered an interest payment, provided the premium (1) is given only when a depositor opens or adds to an account, (2) is not given to any depositor on a recurring basis, and (3) has a value (or a cost to the bank) that does not exceed \$5 (\$10 for deposits of \$5,000 or more). When it last considered these limitations, the Board recognized that such programs may benefit small savers whose monetary returns are limited by law.

Regulation Q, which applies to all member banks of the Federal Reserve System, contains provisions that govern advertisements, announcements or solicitations relating to interest paid on deposits. This regulation includes a number of specific advertising rules--such as requirements that interest rates be stated in terms of the annual rate of simple interest, and that any time and amount requirements necessary to earn an advertised rate be stated conspicuously. In addition, Regulation Q contains the general requirement that a member bank's advertisements must not be inaccurate or misleading, or otherwise misrepresent the bank's deposit contracts.

Under its Truth in Lending authority, the Board has issued rules regarding the advertising of credit terms and consumer leases. The regulation requires banks and other creditors who advertise credit terms to make complete disclosure of related terms. The specific provisions in Regulation Z are intended to ensure that consumers are not told one or two favorable terms only to find out later, when they apply for the credit,

that the overall terms may be a good deal less favorable than represented in an advertisement.

The Board and its staff are now reviewing other practices of banks that may be unfair or deceptive--practices that include but are not limited to bank advertising. During this review, a number of issues needs to be explored thoroughly, including the basic question whether another new regulation is necessary or advisable at this time. Banks have had to absorb a large volume of burdensome and costly new regulations in the last year, particularly under the Financial Institutions Regulatory and Interest Rate Control Act (FIRA), which created new laws governing electronic fund transfers, the right to financial privacy, insider transactions, and so forth.

The cost and burden of a complex regulatory scheme, which will ultimately be borne by depositors and borrowers, must be weighed carefully against the perceived benefits to the public. Before venturing further into the regulatory morass, alternatives must be considered. We should resist the temptation to reach all problems by setting out detailed Federal regulatory standards, and should first seek to resolve these matters through local efforts, industry self-policing, general Federal supervision, guidelines, and policy statements. We believe it would be preferable to try these measures before considering the adoption of any regulations that could lead to our policing every bank promotion and advertisement.

These issues were discussed by the Board's Consumer Advisory Council last February at its quarterly meeting. There was general agreement among Council members that some banking practices were troublesome--from misleading use of the term "free checking" to failure to make adequate

disclosure of account terms to customers. Many Council members--both consumers and creditors--were opposed to issuing new regulations, however, and favored the alternative of guidelines or policy statements.

The Board has taken a number of different approaches in reviewing bank activities that may warrant further consideration as unfair or deceptive practices. First, the staff has been instructed to monitor consumer complaints received by the Board on a continuing basis. There are problems, however, with trying to reach any conclusions on the need for action based on such complaints. Frequently, we have found that complaints are imprecise about what the problem is, or do not give all the facts.

Recognizing these difficulties, the Board in 1977 used another approach. Letters were sent to 400 State agencies and legal service organizations, asking them to identify practices that, in their experience, were prevalent and that could be viewed as unfair or deceptive. After a review of the responses (about 100) to this mailing, four practices were selected for further study:

1. Failing to disclose to new depositors the contract terms governing use of their accounts, or failing to give reasonable advance notification to existing depositors of any change in contract terms.
2. Describing checking account services as being "free" when there are charges for or preconditions to a depositor's actually receiving no-cost checking.
3. Attaching, freezing, or closing a depositor's account without promptly notifying the depositor.
4. Imposing, as a matter of policy, a longer waiting period than needed for operational reasons before depositors can withdraw funds deposited in the form of checks.

A survey was conducted in cooperation with the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation to determine the prevalence of the four practices and to develop more information about the way in which they occur. A questionnaire was developed and incorporated into the three agencies' regular consumer compliance examinations covering all banks examined during a 90-day period in 1978. The agencies thus were able to obtain a sample regarding these practices in 846 financial institutions. The results of the survey were collected in a report that was published by the Board earlier this year. This report has been delivered to this Subcommittee.

The survey results are instructive, although one must be cautious in drawing conclusions from them about the need for Federal intervention. For example, 84% of the banks explained all or some of their checking account terms either orally or in writing to customers upon the opening of an account. Similarly, about half the banks that advertise checking accounts used the term "free checking." In the case of 58% of these, there were some conditions attached. However, in the vast majority of cases--90%--the conditions were specifically disclosed in the advertisement.

One of the other items that has been of major interest relates to "delayed funds availability." This term refers to the practice of placing a hold on consumers' check deposits for certain periods, to give the check time to clear the bank on which it is drawn--or to be returned unpaid. The Bank Practices Survey found that only 38% of banks surveyed will delay fund availability either because of the type of check or because of the location of the bank on which the check is drawn.

Delayed availability can be a frustrating experience for consumers. Yet any requirement that availability delays reflect only "actual time for clearing" also would present a difficult problem, due to the varying times that it may take for dishonored checks to be returned to depositors. The return time for unpaid items is unpredictable. Factors such as the location of the payor bank, or the non-membership of a bank in the Federal Reserve System, may significantly affect collections. The Board's staff is now working with the Bank Administration Institute on how to improve the timing for returned items. If this process could be expedited, it would eliminate the major reason for delayed availability.

The staff also is investigating a number of alternatives regarding bank practices that may warrant action and, if any action is thought to be appropriate, regarding the form it might take. The following are some of the areas under study:

First, should banks be required to disclose, in writing, deposit terms and conditions at the time an account is opened, and to disclose any subsequent changes that may be regarded as unfavorable to the consumer. Items to be disclosed might include the simple and effective rates of interest, account charges and restrictions, and information relating to delayed funds availability. It should be noted that the part of the Electronic Fund Transfer Act that goes into effect in May 1980 includes requirements for detailed account disclosures as to electronic fund transfers made to or from a consumer's account. At present, there are no parallel requirements as to check transactions involving the account.

Second, should banks be required to investigate, within a reasonable time, a customer's allegation that an error has been made by the bank.

Third, should requirements regarding advertising be imposed in addition to those now contained in Regulation Q, with comparable requirements for checking accounts.

The Board has statutory authority under § 18(f) of the Federal Trade Commission Act to prohibit unfair or deceptive acts or practices engaged in by banks. This provision parallels the Federal Trade Commission's power to declare activities of businesses (other than banks and S&Ls) to be unfair or deceptive, and therefore prohibited.

Any rule issued by the Board under its § 18(f) authority would apply only to banks, although the Federal Home Loan Bank Board has recently been granted similar authority as to savings and loan associations by a 1979 amendment to the FTC Act. The Board believes that whatever action may be taken concerning bank practices should not apply only to banks. There should be parallel provisions applicable to other financial institutions--including credit unions and thrift institutions--to ensure competitive equality. The Board's Legal and Consumer Affairs Divisions are consulting with their counterparts at the other financial regulatory agencies to ensure full interagency coordination in this area.