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Statement by

Nancy H. Teeters, Member

Board of Governors of the Federal Reserve System

before the

Subcommittee on Consumer Affairs of the

Committee on Banking, Housing and Urban Affairs

United States Senate

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I am pleased to appear before the subcommittee this morning to deliver the Board's endorsement of the Consumer Usury Study Commission Act. A more analytical approach to the regulation of consumer credit is highly desirable, and the Board hopes that this study commission will make a real contribution to the legislative process.

A study commission will be able to assess the extent to which the recommendations of the National Commission on Consumer Finance have been fulfilled, and, in addition, will be able to update the NCCF's recommendations, particularly with respect to open-end credit, which has grown so rapidly since the NCCF report was published in 1972. While the Board is skeptical that much original research can be accomplished in the time given the commission, we are hopeful that fruitful recommendations will result. The Board and its staff will be pleased to assist the commission to the extent possible.

The Board has previously testified before this subcommittee on the issue of federal rather than state law regulating consumer credit matters. As this subcommittee may recall, the Board did not support the bill that prohibits use of the Rule of 78's in certain transactions. The Board opposed that bill, not because it believes creditors should continue to use the Rule of 78's, but because it believes state regulation is generally preferable to federal. This preference is based not only on general philosophical principles, but also on the basis of experience in attempting to impose a national, uniform disclosure standard under the Truth in Lending Act. While the Board does not recommend retreating from the goal of national, uniform disclosure, it is inclined to recommend that substantive regulation be left to the states.

The Board has generally favored the abolition of artificial rate ceilings that reduce competition among creditors, create unwarranted and unfair subsidies between classes of consumers, and artificially reduce credit availability. Some limit on the amount that can be charged may be necessary for smaller transactions involving necessitous borrowers, but beyond that the Board leans toward allowing competition to set the rate.

The Board would suggest that the question of consumer credit rates not be taken up in isolation from other consumer and creditor rights and responsibilities. Consumer protections often affect revenues or costs and, therefore, are an integral part of any consideration of the rate issue. Furthermore, we believe that a comprehensive approach is far preferable to a piecemeal approach.

While the Board supports the idea of a study commission, it hopes that this subcommittee will, nonetheless, consider the Board's recommendation to integrate the Fair Credit Billing Act and the newly-enacted Electronic Fund Transfer Act. A staff draft of an integration bill was recently distributed to the Board's Consumer Advisory Council, and the Council is expected to give the draft a preliminary review at its meeting next week. The basic good sense of having similar, if not identical, rules for consumers to follow in both credit and debit transactions speaks for prompt consideration of the bill.

The Board continues to support the amendment to Truth in Lending that removes the 5 percent limit on discounts for cash. In addition to the discount bill, you asked that the Board comment on a further amendment that permits merchants to impose a surcharge on credit card as opposed to cash transactions. To begin with, from an economic standpoint, we do not perceive any difference between a discount for cash and a surcharge for credit. Most probably, however, a merchant can administer a surcharge much more easily than a discount.

Permitting cash discounts or credit surcharges makes a good deal of economic sense, in the Board's view, because it allows greater flexibility in allocating costs to those who should bear them. If a credit card transaction costs the merchant more than a cash transaction, then the merchant should have the right to pass that cost along to the card user. If the consumer prefers to use a credit card rather than bear the risks of carrying cash or the inconvenience of using a check, the legislation would not only permit the cardholder to do so, but it would allow a merchant to pass along the cost. The Board supports the bill because it frees up the market, encourages competition among payment mechanisms, and leads to a more equitable distribution of costs.