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, Finance and Urban Affairs

U. S. House of Representatives

February 5, 1981

I am pleased to appear before you this morning to present the views of the Board of Governors on the proposed "Cash Discount Act." Unlike the current law, the proposal provides that a discount -- in whatever amount -- which is offered by a seller to a customer to induce payment by cash, check or other means other than an open-end credit plan or credit card is not a disclosable finance charge under the Truth in Lending Act. The bill would also extend the current ban on the imposition of a credit card surcharge for another two years.

The Board has testified previously in favor of omitting these discounts from the finance charge as a way of encouraging them, and I do so again this morning. Also, as I have done previously, I must express the Board's uncertainty about the wisdom of prohibiting surcharges in view of their economic similarity to discounts. Their permissibility might in fact help assure that cash customers are not forced to subsidize credit card users.

In our view, it is time to take a fresh look at the cash discount issue. During the six years since the Truth in Lending Act was first amended to encourage the offering of cash discounts, the Congress has repeatedly considered the discount/surcharge issue. Testimony has been delivered at length. The Federal Reserve, meanwhile, has carefully constructed regulations to carry out the statutory provisions regarding availability and notice to consumers of discounts. Despite these Congressional and regulatory efforts, what we haven't seen is merchants offering discounts -- at least not to any appreciable degree. If we believe that encouraging merchants to reward cash buyers is a goal worthy of diligent pursuit, then we must try to identify the impediments which have, in fact, discouraged the concept.

Our guess is that the current 5 percent limit on the size of the discount is not the culprit. Rather, it seems to us that this may, once again, be a case of government regulation creating part of the problem -- regulation which is grounded on a set of well-intentioned arguments, but which introduces such friction into otherwise simple transactions, that compliance is simply not worth the merchant's risk or effort.

If this analysis is correct, there are two features in the current regulation that are probably most important in discouraging the development of cash-paying incentive plans. First is the obvious difficulty in drawing a clear economic distinction between a permitted discount and a prohibited surcharge. It is true that discounts and surcharges may not be as identical in practice as, say, a half empty glass of water is to a half full one. Nevertheless, it is difficult to quarrel with the fact that the distinction is, at best, uncertain.

Second, the well-intentioned protections in the statute to insure equitable treatment of consumers have, once again, led to the seemingly complicated regulatory provisions attached to my statement. The current statute and the proposed bill specify that any discount must be offered to "all prospective buyers." Its availability must be disclosed to all of them "clearly and conspicuously in accordance with regulations of the Board." But who are "all prospective buyers"? Those who present credit cards, or all those who enter the merchant's door? What signs meet the test of "clear and conspicuous" disclosure when there are several store entrances, and numerous independent cash registers? How do you disclose to customers who purchase by phone? May the discount be limited to certain types of property? How about to certain branches of stores? We have sought to provide answers to these questions in our regulations.

Unfortunately, by issuing rules beyond the basic provision we have again probably made simple things so complicated that the public throws up its hands in frustration. Although in our current proposals to simplify Regulation Z we have proposed trimming back these regulations, the obvious way for any merchant to avoid regulatory burden is simply not to offer discounts. And that, apparently, is what has happened.

I therefore would recommend for Subcommittee consideration a very simple rule: that one time discounts or surcharges offered by the seller for the purpose of inducing payment by cash, checks or means other than use of an open-end credit plan or a credit card shall not constitute a finance charge, and that the availability of the discount or surcharge be disclosed to customers. This would leave out the specific requirement that "all" customers be notified and that any disclosure be "clear and conspicuous" -- not, of course, because we favor hidden plans but because of the uncertainties this standard produces with the inevitable need for clarification.

Of course, it is possible that authorizing discounts and surcharges without calling them finance charges opens up a potential loophole in the blanket embrace of Truth in Lending. Not only are discounts essentially equivalent to surcharges, but both are essentially equivalent to finance charges. They do represent a cost of using credit.

Therefore, if we are right that the 5 percent limit has not itself been the impediment to merchants offering discounts, this limit might be retained to insure that the exclusion of discounts and surcharges does not become a vehicle which could be used to defeat the basic Truth in Lending protections. In our view, the best chance of accomplishing the goals Congress began pursuing six years ago would be to retain this limit, but allow discounts and surcharges to be used with minimal further governmental interference.