Research Department
Federal Reserve
Bank of
San Francisco

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Consumers and Creditors

With the spread of automated billing systems, consumer complaints about problems in correcting errors—or obtaining refunds in the case of unsatisfactory goods—eventually became a concern of Congress. The Fair Credit Billing Act (FCBA) was the result. This Act set forth the rights of consumers in the settlement of billing errors, and assigned to the Federal Reserve the responsibility for preparing an appropriate regulation to govern enforcement. Credit users and credit issuers will soon be affected by these new rules, which were published last month as part of the Fed's Regulation Z.

In general, all credit cards and other open-ended lines of consumer credit are subject to the new regulation. Merchant credit and bank credit, credit cards and charge accounts are all covered. The regulation spells out the steps to be followed by a credit user in initiating a complaint and it establishes rules to ensure an appropriate response by the creditor. Creditors are required, on the first billing date after the end of this month, to send their customers a description of their rights and of the procedures to follow in making complaints.

Correction of errors
Under the new regulation, a customer must notify the creditor in writing of any billing error within 60 days of billing, giving enough information to allow the creditor to identify the account concerned and the details of the complaint. The legislation was designed to correct for such errors as the unauthorized use of a customer's credit card, incorrect charges, incorrect finance charges, and failure to credit payments already made. The customer is permitted to withhold payment (with certain exceptions and/or limitations) when he is unsuccessful in resolving a dispute with a merchant over defective merchandise, or is billed for goods or services wrongly delivered or not accepted.

Once proper written notice has been received, a creditor must acknowledge the customer's letter within 30 days and then take steps to resolve the dispute within 90 days. During this period, a customer need not pay any amount in dispute nor be liable for interest on the items described in his written notice. (The customer would still be liable for interest charges on items not in dispute.) A creditor cannot close an account because the customer is not repaying an amount in question, and he cannot make an adverse credit rating before complying with all procedures specified in the regulation.

The regulation is designed to make creditors more responsive to customers' complaints of errors, and to ensure that customers are not subject to penalties in the form of service charges or adverse credit ratings whenever complaints are being investigated. On the other hand, a complaining customer

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must give the creditor sufficient information about any disputed item to allow the problem to be identified and resolved.

Billing requirements

The FCBA regulation also covers business billing procedures. When descriptive billing is used—that is, when no copy of the bill is returned—the statement must show the date and type of transaction. In bank and other third-party credit-card statements, the name and address of the merchant involved must be shown. When a grace period is allowed, during which payment in full avoids interest charges, the statement must be mailed 14 days before the end of that period.

Bank credit-card issuers cannot collect payments from a customer's deposit account as long as a dispute is unresolved. This prohibition applies even when the customer has agreed to automatic collection of payments. Banks can use a customer's deposit balance to offset debt only through court order or other procedures legally open to creditors.

Discounts for cash?

The Fair Credit Billing Act contains an interesting new feature, which would prohibit credit-card issuers from trying to keep merchants from offering cash discounts. Consumer organizations had favored this on grounds of discrimination against cash customers, who were not utilizing the credit service but were bearing some of the costs of credit. The law specifies a 5-percent limit on such cash discounts, but the law does *not* require that they be given.

The impact of this section of the Act may be much smaller than consumerists hope, or merchants fear. In practice, banks issuing credit cards have found the provision against cash discounts in existing contracts difficult to enforce. The average merchant discount on bank cards runs about 3 percent, so that there is not much for the customer to bargain about. Furthermore, the regulation requires that any merchant offering a cash discount must post signs conspicuously announcing such discounts. A similar notice is required in advertisements. Thus, the merchant must offer cash discounts to all customers, and cannot bargain with customers individually. Since an across-the-board price reduction of this type would entail a significant revenue loss, retailers are discouraged from offering such inducements. Certainly, merchants operating their own credit systems are unlikely to give discounts, if they do not offer them now.

To some degree, the cash-discount provision reflects a suspicion that bank credit cards significantly raise selling costs. This suspicion is not well founded. Credit-card transactions largely originate in businesses where credit has been traditionally available, so that much of the recent growth of bank credit cards simply represents a displacement of merchant credit by bank credit. Moreover, to the degree that bank systems are more efficient, they actually may reduce costs for many businesses. Bank cards even offer merchants some advantages over non-credit purchases. When a merchant accepts checks he absorbs bad-check losses, but when banks issue credit cards, the banks (not the merchants) absorb any fraud and bad-debt losses. Indeed, with merchant discounts near 3 percent, the cost impact of credit cards is small, and at the current interest-rate levels, many businesses would find it difficult to offer equally priced credit to their customers.

In addition, the claim of discrimination against cash customers does not support any argument that cash discounts *should* be given. Businesses regularly attach "free" services to their merchandise to attract customers, but all customers do not use "free parking," or "free delivery," or "free gift wrapping"—let alone "free credit." These free services are not costless. However, the costs of specific services can only be judged against the overall pattern of a business, and there is no inherent reason why discounts should be given to those refusing one service as for those refusing any other service. The relevant principle is that the choice for making specific charges on services should properly be left to the merchant, whether it is "free" parking or "free" credit. This is all the regulation does; it leaves the choice to the merchant, subject to the requirement that all customers be offered the same option.

* * *

The Fair Credit Billing Act, in summary, sets forth certain consumer rights to help cope with some of the problems of an increasingly automated world. The credit customer is given important rights, such as the right to force creditors to respond to inquiries about possible errors, and the right to do so without the threat of either a closed account or an adverse credit rating. The regulation embodies consumer-relation practices which most creditors follow as a matter of course. There are also indirect benefits. To the extent consumers feel more secure in a world of computer billing systems, further technical innovation leading to automated billing and payments systems may well be encouraged.

Robert Johnston

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT
(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 10/01/75	Change from 9/24/75	Change from year ago Dollar	Percent
Loans (gross, adjusted) and investments*	86,428	+ 869	+ 2,883	+ 3.45
Loans (gross, adjusted)—total	64,767	+ 605	− 2,147	− 3.21
Security loans	1,023	+ 7	− 285	− 21.79
Commercial and industrial	23,127	+ 400	− 1,006	− 4.17
Real estate	19,564	− 1	− 337	− 1.69
Consumer instalment	10,055	+ 16	+ 317	+ 3.26
U.S. Treasury securities	9,022	+ 211	+ 4,935	+ 120.75
Other securities	12,639	+ 53	+ 95	+ 0.76
Deposits (less cash items)—total*	86,674	+ 597	+ 5,665	+ 6.99
Demand deposits (adjusted)	24,025	+ 246	+ 1,603	+ 7.15
U.S. Government deposits	227	− 88	− 486	− 68.16
Time deposits—total*	60,782	+ 164	+ 4,425	+ 7.85
States and political subdivisions	5,753	− 52	− 407	− 6.61
Savings deposits	20,978	+ 202	+ 3,071	+ 17.15
Other time deposits‡	30,192	+ 39	+ 1,356	+ 4.70
Large negotiable CD's	16,409	+ 12	+ 980	+ 6.35

Weekly Averages of Daily Figures	Week ended 10/01/75	Week ended 9/24/75	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves	129	35	+ 163
Borrowings	135	19	132
Net free (+) / Net borrowed (−)	− 6	+ 16	+ 31
Federal Funds—Seven Large Banks			
Interbank Federal fund transactions			
Net purchases (+) / Net sales (−)	+ 128	+ 981	+ 240
Transactions of U.S. security dealers			
Net loans (+) / Net borrowings (−)	+ 438	+ 668	+ 937

*Includes items not shown separately. ‡Individuals, partnerships and corporations.

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