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Statement by

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Chairman, Board of Governors of the Federal Reserve System

before the

Subcommittee on Production and Stabilization

of the

Senate Banking and Currency Committee

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Mr. Chairman and Members of the Committee:

You have asked me to comment on S. 2755, a bill to require disclosure of finance charges in connection with extensions of credit. First, I should like to say that the protection of borrowers by regulating the trade practices of those who extend credit to them is a commendable social and economic objective. As the Committee knows, this has been recognized in the passage of legislation in many States which requires lenders and vendors to set forth the charges which are made in connection with instalment sales and consumer loans.

The bill before you goes further than most State laws in several respects. It covers a broader area than is generally encompassed by State legislation and it also requires that the finance charges be translated into a simple rate of interest. Its objective, as stated by the Chairman of this Subcommittee, is "to require lenders and vendors to tell the truth about interest rates and finance charges."

Before proceeding, I should like to emphasize that I am not personally an expert on finance charges in the consumer credit field. Nor is regulation of lenders' and vendors' trade practices a current responsibility of the Federal Reserve System. I am sure that there are numerous technical problems involved in applying the requirements of the bill to the wide variety of credit transactions it comprehends. Even if business loans were exempted, the proposed regulation would apply to hundreds of millions of individual transactions, carried out by over 50,000 financial institutions and hundreds of thousands of retail outlets.

As was indicated to your Committee in our written response, the Board's most immediate concern is with the provisions of the bill which would place responsibility for its administration in the Federal Reserve System. We feel that the administration of such legislation would not constitute an appropriate activity for the Federal Reserve System.

It would require the Federal Reserve to police the trade practices of hundreds of thousands of credit granters over which it now has no supervisory authority. The major activities of most of these are far removed from basic Federal Reserve responsibilities, and their operations entail practices and problems with which the Federal Reserve is totally unfamiliar. As the Chairman of this Subcommittee has pointed out, it is not the purpose of this bill to control credit. It is not intended that the regulatory requirements would be varied from time to time to encourage or discourage the volume of credit extended. Accordingly, the reasoning that in the past has prompted the Congress to assign responsibility for stock market, consumer instalment, and real estate credit regulations to the System would not seem to apply in this case. The fact that adaptation to changing economic conditions is not involved also suggests that a possible alternative solution might be to recast the bill as a criminal statute, not designed for administration by a regulatory authority, and to be enforced by regular law enforcement agencies.

As you know, the major responsibilities of the Federal Reserve relate to the supply, availability, and cost of credit and money. The System is interested in movements of consumer credit primarily as they affect changes in the total volume of credit. It has also the responsibility of supervising member banks to ensure sound banking practices; this

is closely related to its responsibilities in the monetary area. Our principal objection to giving the Federal Reserve responsibility for administering this legislation is that it does not pertain to the control of credit. Full disclosure between parties to credit transactions is, in the final analysis, a question of trade practice and the prevention of fraud. A whole body of legal precedent and regulatory procedure, with which we are unfamiliar, is involved. It is alien to our existing activities.

I am not aware of the extent to which your Committee has had an opportunity to study the experience of the States which have had disclosure laws in force. It would seem that their experience might be of some assistance in determining the most effective approach to regulation in this area, particularly with respect to problems of administration and enforcement. Certainly, their experience is more directly relevant than any incidental experience gained by the Federal Reserve in conjunction with either its past or present responsibilities.

In its present form the bill seems to us to raise a number of difficult problems of administration and enforcement. It may be worthwhile to investigate how States operating under similar laws have overcome these problems. For example there is the question of identifying which lenders and vendors should be subject to the terms of the bill. Many vendors that do not normally charge for credit granted may, on occasion, levy penalties for late payments and thus be subject to the terms of the proposed legislation. Also, some light might be shed on how best to deal with the large number of cash loan transactions between individuals.

Another problem is to define finance charges, which are of many kinds, and which may or may not be graduated with the amount or maturity of the credit involved. Many of the instalment transactions that would be covered include not only financing, but also the provision of insurance and other services for which a fee is customarily charged. The way in which States have coped with separating the total cost of the transaction into cash price, finance charges, and charges for other services would be illuminating. States have undoubtedly faced the difficulties that would be encountered if the requirements led some credit granters to attempt to conceal finance charges in the cash price of the goods or in the costs of additional services provided.

The conversion of charges into simple interest rates presents problems going beyond the experience of the various States, but which seem to us to require further consideration. Very detailed and complex instructions would be needed to assure uniformity among credit granters. Examples of the kind of problems that would have to be treated explicitly are the handling of such charges as commitment fees and required insurance and provisions for prepayment and late payment penalties. Leasing arrangements, which are becoming increasingly common in many durable goods areas, would be exceedingly difficult if not impossible to handle.

As I remarked at the outset, men of good will wish the consumers not to be deceived by lenders and thus fail to receive the value they thought they had bargained for. Caveat emptor can scarcely operate in the absence of knowledge by the potential buyer and debtor as to how much he is really paying.