iam McChesney Martin, Jr., Papers

26/Folder 5

Series V, Subseries D

Hearings, July 1961

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## HEARINGS

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(53)...Subcommittee on Production and Stabilization, Senate Banking and Currency Committee (Paul Douglas, Chairman) ..................S. 1740, "Truth in Lending" Bill ...........7/19/61

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CHAIRMAN MARTIN

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C O P Y

August 16, 1961

Honorable Wright Patman, Chairman
Joint Committee on the Economic Report
United States Congress
Washington, D. C.

Dear Mr. Patman:

I regret that I could not accept your invitation to appear at the current hearings of the Joint Committee on the Economic Report, to testify regarding the recommendations of the Commission on Money and Credit concerning the structure of the Federal Reserve System. I realize that a memorandum of views is not a wholly satisfactory substitute for an appearance before the Committee, with its opportunity for questioning by interested Committee members. Nevertheless, since the subject is one in which I have a keen interest, and a degree of knowledge based on thirty-six years spent in the Federal Reserve System, I have thought it worthwhile to use this means of placing my views before the Joint Committee.

To identify myself in the manner which has become customary at hearings of the Committee, my name is Allan Sproul, I am a director of the Wells Fargo Bank and American Trust Company of San Francisco and of the Kaiser Aluminum and Chemical Corporation of Oakland, California, and I was president of the Federal Reserve Bank of New York and vice chairman of the Federal Open Market Committee for fifteen years from 1941 to 1956. In presenting my views, however, I represent no one but myself; neither the private business community, the commercial banks, nor my former associates in the Federal Reserve System.

I should also mention, I think, that I was named as a member of the Commission on Money and Credit when it was first being organized in February, 1958. In preceding years I had been among those who had advocated a study of our financial system by a national monetary commission established by the government, and composed of a small number of men competent in the field, experienced in economic matters, and with a reputation for objectivity. This official or government commission did not come to pass. As a second choice, the private commission sponsored by the Committee for Economic Development seemed to offer a partially satisfactory means of bringing our financial machinery under scrutiny and suggesting possible ways of improving it. When I accepted appointment to the Commission in February, 1958 it was to be a Commission of fifteen members "chosen for their individual qualities, not as representatives of organizations or sections of the community" with a "balanced representation of philosophies and approaches." In mid-April 1958 I was advised that it had been decided that "for more ideal balance the Commission should be expanded to a minimum of twenty-five, bringing about representation of areas, points of view and interests which were not adequately provided for in the Commission of fifteen as originally planned." I learned of the membership of the enlarged Commission by way of a press release on May 29, 1958. On June 12, 1958 I withdrew from the Commission. My resignation was announced in a press release of the Commission on January 22, 1959.

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So much for identification. As you requested, I now address myself to that part of the recently published report of the Commission on Money and Credit (CMC), which has to do directly with the structure of the Federal Reserve System. In this area, at least, I suggest that the CMC, in its efforts to compromise the various points of view and interests of its members, produced a doubtful package of recommendations. Some of them are good but, in the aggregate, they represent an attempt to pacify those who would "nationalize"* the Federal Reserve System by destroying its federal character, and they tend to water down the symbols of support of the System by the private financial community to the point of poisoning rather than preserving a relationship which has made successful evolutionary progress for half a century. I directly challenge, therefore, so far as the structure of the Federal Reserve System is concerned, the statement of the CMC in the introduction to its report, that it has tried to "confine its recommendations and suggestions for change only to situations where the present structure has not worked well."

What are the recommendations and suggestions of the CMC for changes in the structure of the Federal Reserve System?

1. The FRB (Board of Governors of the Federal Reserve System) Chairman and Vice Chairman should be designated by the President from among the Board's membership, to serve for four year terms coterminous with the President's.

2. The FRB should consist of five members with overlapping ten year terms, one expiring each odd-numbered year; members should be eligible for reappointment.

3. The FRB Chairman should be the chief executive officer of the Board, empowered to handle administrative matters. The law should be clarified to authorize the Board to delegate to Board Committees or to Board members individually, or to senior staff officers of the Board, any of its functions in the administration of its powers in regard to the supervision of the banking structure, etc. Any actions so delegated should be subject to review in the Board's discretion.

4. Occupational and geographical qualifications for Board members should be eliminated. Instead, the statute should stipulate that members should be positively qualified by experience or education, competence, independence and objectivity commensurate with the increased responsibilities recommended for them in the achievement of low levels of unemployment, an adequate rate of economic growth, and reasonable stability of price levels in the economy. Salaries of top officials throughout the government should be sharply increased and, in view of the gravity of their responsibilities, FRB members should be compensated at the highest salary level available for appointive offices in the government.

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* A vague general term used to frighten conservatives.

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5. The present statutory Federal Advisory Council should be replaced by an advisory council of twelve members appointed by the Board from nominees presented by the boards of directors of the Federal Reserve Banks, etc.

6. The law should formally constitute the twelve Federal Reserve Bank presidents as a conference of Federal Reserve Bank presidents, to meet at least four times a year with the Board, and oftener as the Board finds necessary.

7. The determination of open market policies should be vested in the Board. In establishing its open market policy, the Board should be required to consult with the twelve Federal Reserve Bank presidents. The determination of the rediscount rate (the same for all Reserve banks) should be vested with the Board. In establishing this rate the Board should be required to consult with the twelve Federal Reserve Bank presidents. The determination of reserve requirements should continue to be vested in the Board. In establishing these requirements, the Board should be required to consult with the twelve Federal Reserve Bank presidents.*

The first five of these recommendations, which I would characterize as the trimmings of this section of the report of the CMC, might be accepted, I think, as moves in the right direction.

The suggestion that the terms of office of the Chairman and Vice Chairman of the Board be made coterminus with the term of office of the President has been attacked by those who see this as an attempt to introduce partisan politics into the functioning of the Board, which is a sin we all deplore. The facts of the matter as I have observed them, however, are that the Chairman of the Board really serves largely at the will or pleasure of the President now. The Chairman of the Board is the chief point of contact between the Board and the President, the Secretary of the Treasury, the Council of Economic Advisers, and all of the most important officers of the executive branch of the government, and only to a slightly lesser degree with the Congress. If he is persona non grata at the White House, his ability to carry out the duties of his office is so gravely damaged as to make it impractical and unwise for him to continue as Chairman. The present wording of the law concerning the term of office of the Chairman seems to me merely to mask this fact of life. I do not mean, however, that the Chairman of the Board must become a subservient political appointee; he retains the right and the duty to represent the Board fairly and forcefully in expounding its views and methods, and preserves the individual right of resignation without disloyalty to the President, or party, if he decides that his service as Chairman is no longer compatible with the economic policies being followed by the government.

* In veering toward centralized control within the Federal Reserve System the CMC, quite rightly I think, avoided the recommendation sometimes put forward that the Board as well as the Federal Open Market Committee be abolished, and our monetary affairs placed in the hands of a single executive. This country has shown a healthy aversion to "czars", and a continued liking for checks and balances.

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A reduction in the number of members of the Board from seven to five, and in the terms of office from fourteen to ten years, with eligibility for reappointment, should make a modest contribution to improving the quality of the Board membership. And, as the report of the CMC says, it is a suggestion which retains stability of membership, protects independence in expressing views and advocating policies which may not be popular, and provides some safeguard against superannuation.

The recommendation that a means be sought to make clear that the Board, as a whole, is not to be enmeshed with routine administrative matters, to conserve its members' time, and to arrange for the more expeditious disposition of its case-load of business, has merit. The success of the suggestion is bound up, however, with questions of the qualifications for Board membership, the size of the Board, and the extent to which the individual members participate with the Chairman in working out coordination of monetary policy with the general economic policies of the government. One reason for the implied "congestion of detailed business at the top" at the Board, is the drug-like attraction of such business when sitting in your office pondering the broad issues of monetary policy becomes tedious.

There is no question in my mind that the present occupational and geographical qualifications for Board members have outlived whatever sound purpose they ever had. They represent an embryonic phase of thinking concerning the role of a central banking system in this country. The general statement of qualifications suggested by the CMC is much more in tune with the responsibilities of the Federal Reserve System, present or proposed, and with the need to abandon ideas of finding effective national monetary policies in an atmosphere of representation of special interests. The companion recommendation of increased salaries for Board members has become a standard item in all considerations of the membership of the Board. The insistency with which this recommendation has been ignored by the executive and legislative branches of the government suggests that there is a roadblock to its acceptance which does not have to do with the specific merits of the recommendation.

The suggestion of the CMC concerning the Federal Advisory Council appears to be an attempt to rescue from possible eventual extinction a body which was established in the early days of the Federal Reserve System as a sop to the bankers who had been ruled off the Board on the theory that you don't make game wardens out of poachers. Although the Board can seek advice from whatever individuals or groups it chooses under its general powers, there is some merit in retaining a statutory body, outside the government and the Federal Reserve System, with which the Board must consult from time to time, and which has statutory authority to ask questions, seek information and proffer advice. I do not think, however, that it is necessary or desirable to change the method of election of members of the Federal Advisory Council. What is necessary and desirable is to smash the tradition, growing out of the early history of the System, that the members of the Council elected by the boards of directors of the Federal Reserve Banks should be commercial bankers. Relieved of this anachronism, the boards of directors of the district banks are much better able to select representatives of their districts than is a Board at Washington, and the privilege is a desirable one in the relations

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between the Board and the districts. Turning the present election process around, so as to make the Board the final appointing authority, seems to me to be a picayune obeisance to an obsession with what the CMC calls the influence of the "private base" of the System.

Now we begin to get down to the meat in the coconut. The recommendation that the law should formally constitute the twelve Federal Reserve Bank presidents as a conference, to meet at least four times a year with the Board, is an unnecessary and spurious attempt to seem to increase the stature of the presidents of the Federal Reserve Banks, who are to be deprived of their most important function by the next recommendation of the Commission. The conference of presidents of Federal Reserve Banks has been in existence for years; it meets regularly to discuss matters of credit policy and Federal Reserve administration; it consults with the Board as a necessary corollary of their joint responsibilities. The sanctions of tradition and long practice have given it a place and stature in the working of the Federal Reserve System, to which statutory recognition can neither add nor detract.

Having paid a left hand compliment to the presidents of the Federal Reserve Banks in this recommendation, the CMC in its next recommendation relegates them to the role of branch managers by proposing that all of the main powers of the System in the field of monetary policy should be lodged in the Board, with only advisory participation by the presidents of the Reserve Banks. It does this, first, on the ground that these powers - determining rediscount rates, deciding open market policy and fixing reserve requirements - "should be complementary and governed by the same considerations, that is by the same people in the same forum." And, second, the CMC says that the exercise of these powers belongs exclusively in the hands of public officials, that is the Board, and that there should be no ambiguity about where this responsibility lies.

The Commission is right, of course, in saying that these powers should be and are complementary, and it is right in saying that they should be exercised by public officials, but the fog of compromise evidently concealed from the Commission the logical suggestion, based on successful experience, that the place to lodge these complementary powers is in the Federal Open Market Committee (as it would be constituted by the present formula, if the size of the Board were reduced from seven to five members). The Federal Open Market Committee has become the heart of the Federal Reserve System; cut it out and you have a skeleton. It is a unique development in central banking which has evolved out of the experience of the System with the needs of a country of the size and character of the United States.* It is made up of men having statutory responsibilities, who serve on the Committee as individuals under law, and who are public officials and public servants in every real sense. Finally, the present constitution of the Federal Open Market Committee observes the cardinal principle of central banking that those who determine monetary policy should not only coordinate

* This argument should not be confused with ideas which were prevalent in the early days of the Reserve System concerning regional differences in monetary policy. Monetary policy must now be national, except in minor degree, but the whole is still the sum of its parts and regional conditions are important in formulating national policies.

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their actions with the general economic policies of the government, but should also have a direct contact with the private money market - a contact which comes from living in the market, operating in the market, knowing the people in the market, and being able to feel the pulse of the market by hand from day to day, and not by random telephone calls or by reviewing cold statistics.

Here, I think, is a tender point with some members of the Joint Committee and indeed of the whole Congress, and with some people in the Federal Reserve, but it cannot be avoided. The first and most direct point of contact between the policies of the monetary authorities and our national and international monetary systems is the New York money market. This is no device of greedy men and no accident of geography which can be changed by legislative fiat. It reflects the necessity, in a money economy such as ours, of having a market place where the final and balancing transactions of our national and international accounts can be carried out by a variety of delicately constructed financial institutions. And the operating arm of the Federal Reserve System in the principal money market of the nation, and of the world, is the Federal Reserve Bank of New York. The Banking Act of 1935 recognized that inescapable fact, and the need for a living link between monetary policy and the money market, by requiring that the president of the Federal Reserve Bank of New York must be a continuing member of the Federal Open Market Committee. All Federal Reserve Banks are equal, but the Federal Reserve Bank of New York is first among equals.

I can only surmise why the CMC decided that the Federal Open Market Committee should be dismantled. The statement that the "distinction between the Board and the Federal Open Market Committee has outlived its usefulness" raises questions, but answers none. From the language of other sections of the report, I would guess that those members of the CMC, who might have argued for the retention of the Federal Open Market Committee if they had known more about it, were lulled into acceptance of its abandonment as a "package deal" by those who were united in promoting the idea that private influence still permeates the Federal Reserve System, and must be eliminated if the System is to discharge its public functions properly and merit the complete confidence of the government and the nation.

The report first constructs a neat word-pattern to describe the structure of the Federal Reserve System, and it then states that a basic issue concerning the System is the "degree of independence of the Federal Reserve ..... from the banking community which it both serves and regulates."

It is my view that the word-pattern - a System with a regulated private base, a mixed middle component, and a controlling public apex - is neat, but inaccurate. In all of its operations in the area of monetary policy I assert that the Federal Reserve System (Board and Reserve Banks) is a public institution, as it must be to discharge the public functions vested in it by the Congress. Clearly, the Board is a public body. It is equally clear to me that the Federal Open Market Committee, on which the presidents of the Federal Reserve Banks serve, as individuals, by statutory appointment, is a public body and not a "mixed middle component." The report of the CMC seems to rest its contrary view on the statement that the presidents of the Federal Reserve Banks are not government appointees, but are elected by and have their compensation fixed by the boards of directors of their banks, subject to the approval of the

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Federal Reserve Board. If the Commission had pursued this lead further, it would have known that approval by the Board of appointments and salaries of presidents of Reserve Banks is not a perfunctory power. The Board has demonstrated on numerous occasions that it is an active veto power, so that there is final public control. But this is more quibbling with words than meeting the real issue. The real answer is that you do not achieve honesty and integrity and unswerving devotion to the public interest by way of appointment procedures, but by charging competent men with an undivided responsibility for public service. That is the case with respect to the presidents of the Federal Reserve Banks as they serve by statutory appointment on the Federal Open Market Committee. They have no allegiance to private business in these matters, except as they try to contribute to the attainment of high level production and employment, sustainable economic growth and a stable price level by monetary means.

The report of the CMC goes on to fill out its pattern of the "public - private category" within the Federal Reserve System with a brief discussion of the Federal Reserve Banks, but it quickly admits that "very tangibly as well as legally the Reserve Banks are public service institutions, and that their private 'ownership' is a highly attenuated right." In a rather odd "on the other hand" the report goes on to say, however, that the salaries of Reserve Bank presidents and their staff salary scales are set at going market rates rather than government levels; "the Reserve Bank presidents are not public servants in the usual sense." In my book this is no more than pandering to confused public ideas about conflict of interest. The salaries of Federal Reserve Bank officials and staffs are set at going market rates so that the banks can attract the quality of administrators and personnel needed to assure the qualities and services necessary for constructive participation in determining monetary policy, and efficient operation in the communities in which they live. I would say that it is fortunate and in the public interest that they are able to do this, so that numbers of capable, competent men can make a career of service in the Federal Reserve System, away from the hazards of political appointment, without the support of family or personal wealth, and without engaging in outside activities of any kind to supplement their regular compensation. There is no entering wedge for conflict of interest here.

The only specific suggestion which the Commission makes concerning the Federal Reserve Banks is that the present form of stock ownership of the banks should be retired, and that membership in the System be continued by a non-earning certificate of, say $500, the same for each member bank. This seems to me to be knocking down an already "attenuated" straw man, in so far as it represents a belief or a suspicion that somehow private interests have a nefarious influence in, or derive special benefits from, the Federal Reserve System. As my previous remarks have indicated, however, I would be concerned if insistence upon the present form of stock "ownership" were to be interpreted as supporting such belief or suspicion. I would rather have the stock subscription changed to a certificate of membership than to have any cloud over the character of the Reserve Banks as public institutions.

There is one other point here that is worth mentioning, however. I have referred to the statement in the report of the CMC that a basic issue with respect to the Federal Reserve System is its degree of independence from the

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banking community which it both serves and regulates. This statement tends to confuse the monetary powers of the Federal Reserve System and its bank supervisory powers. In discharging its duties as a bank supervisor the Federal Reserve System may be a government agency with an agency-clientele relationship with the business concerns it both serves and regulates, in the words of the Commission, but in the vastly more important realm of monetary policy the Federal Reserve has no agency-clientele relationship with anyone but the American people as a whole. If the bank supervisory powers of the Federal Reserve System are the reason for concern about the "ownership" of the stock of the Federal Reserve Banks by the member banks, consideration should be given to consolidating the regulatory functions of Federal banking authorities outside the Federal Reserve System, as suggested in a footnote by some members of the CMC. The "regulated private base" of the System (the commercial banking system), in the word pattern of the Commission, is not the base of the System as a monetary authority. It is the private monetary mechanism which serves as a channel through which the monetary actions of the System spread out through the whole community, pervasively but without unnecessary intrusion upon private transactions between citizen and citizen.

Now let me close by coming back to the question of the Federal Open Market Committee, which is by far the most important question to which the CMC addressed itself in the section of its report on the structure of the Federal Reserve System. I do not believe that many of the members of the Commission realized the full import of what they were doing when, actively or passively, they acquiesced in recommending that the Federal Open Market Committee be abolished. I have said it is the heart of the Federal Reserve System as it has evolved over the years, and it is. It is the forum where representatives of the constituent parts of the System - the Reserve Board and the Reserve Banks - meet as individuals and equals, bearing identical responsibilities under law to decide questions of high monetary policy. It is the group within the System which brings to the consideration of policy, knowledge of what is going on in government, in the money market, and in commerce, industry and agriculture throughout the country.* Its members take back to the government, to the money market, and to the country, an understanding of what has been decided which is an essential ingredient of effective monetary policy.

I have said that if you remove the presidents of the Federal Reserve Banks from continuous (in the case of New York) or periodic (in the case of the others) participation in this high function you will tear down the spirit and morale of the twelve Banks, and I believe it. The men who are the most capable and imaginative officers of Federal Reserve Banks, and who staff their outstanding economic research departments, are not primarily interested in counting coin and currency, in sorting checks, and in examining member banks. They and their successors won't be attracted to jobs in which these operating chores are their only direct and primary responsibility; jobs in which they are only called upon as consultants and advisers in matters of monetary policy. Participation

* This form of words does not exclude labor, or consumers, or any other group within the body economic, although organized labor has ordinarily been suspicious of the Federal Reserve and has generally refused to become better acquainted, even when asked to do so.

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in the work of the Federal Open Market Committee, with authority and responsibility - the right to vote as well as to talk - is what attracts the best men to the chief offices of the Federal Reserve Banks, and it is this contact which fills their official staffs with a sense of dedication and high purpose.

I sincerely hope that the Congress of the United States will never reverse itself on this important matter. I sincerely hope that it will go forward to complete the ingenious work of the Banking Act of 1935, by combining in law in the Federal Open Market Committee the complementary powers of the Federal Reserve System with respect to open market operations, rediscount rates, and reserve requirements.

Thank you for giving me this opportunity to present my views to your Committee.

Sincerely,

Allan Sproul

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3,600,000 = 100,000

Tonight I hope none of you will carry away the impression I take myself too seriously but that all of you will recognize the seriousness of the money and credit of ~~a nation~~ this. To a foreigner, much more than to Americans

~~I want to talk informally~~

To night I want to make some observations on a very important subject: the money and credit of the United States. To a foreigner, much more than to Americans, the dollar is a symbol of this country's strength. Formal devaluation of the dollar would suggest ~~to him~~ a decline not only in American economic strength but also in moral force. This is a matter of paramount importance. Yet since 1946 we have witnessed a decline in purchasing power to such an extent that we now have a 65¢ dollar and there has been relatively little complaint from the consumers who have borne the main burden.

From the earliest history of our republic this has been recognized and our Federal Reserve System is a ~~response~~ direct response to this our contemporary response ~~to this~~

the primary bulwarks of the enterprise

defense against this contingency. It is vital that this be understood.

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Subcommittee on Production and Stabilization
Senate Banking and Currency Committee

Paul Douglas, Chairman
Willis Robertson (Va.)
Joseph Clark (Pa.)
William Proxmire (Wisc.)
Harrison Williams, Jr. (N.J.)
Edmund S. Muskie (Me.)

Wallace Bennett (Utah)
Homer Capehart (Indiana)
Prescott Bush (Conn.)
J. Glenn Beall (Md.)

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Chairman Martin

June 28, 1961.

To: Chairman Martin

From: Jerome W. Shay

Subject: Hearings on Federal Reserve branch, truth-in-lending, and certain other bills.

Senator Robertson has announced that the Senate Banking and Currency Committee will hold hearings on July 10, 1961, beginning at 10 a.m., on four bills, one of which is S.1005, to remove the statutory ceiling on the cost of Federal Reserve bank branch buildings.

The other three bills are:

S.1486, to authorize the Comptroller of the Currency to establish maximum service charges which may be levied on dormant accounts by national banks. The Board reported to the Committee on this bill on May 4, 1961, that the Board had no objection to the bill;

S.1771, to amend section 25 of the Federal Reserve Act to permit the Board to authorize foreign branches of national banks to compete on a more equal basis with institutions in the countries in which the branches are located. The Board filed a favorable report on this bill on May 12, 1961;

S.2130, an Administration bill to repeal certain obsolete provisions of law relating to the mints and assay offices.

Senator Douglas, Chairman of the Subcommittee on Production and Stabilization of the Senate Committee on Banking and Currency, has announced hearings on his bill, S.1740, known as the "truth-and-lending" bill, to begin on July 17, 1961. Senator Douglas said that the hearings would run through at least July 20 and suggested the likelihood that four days would not be sufficient time in which to complete the hearings.

No announcements have yet been made as to who will be called to testify at either set of hearings, and it is understood that committee and subcommittee intentions in this respect have not yet crystallized fully.

cc: Each Board Member
Messrs. Thomas, Young, Molony, Fauver,
Sherman, Hackley, Farrell and Noyes.

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87TH CONGRESS
1ST SESSION

# S. 1740

IN THE SENATE OF THE UNITED STATES

APRIL 27, 1961

Mr. DOUGLAS (for himself, Mr. PROXMIRE, Mrs. NEUBERGER, Mr. CLARK, Mr. LAUSCHE, Mr. CASE of New Jersey, Mr. MAGNUSON, Mr. JACKSON, Mr. YARBOROUGH, Mr. YOUNG of Ohio, Mr. MCNAMARA, Mr. CHURCH, Mr. MORSE, Mr. GRUENING, Mr. MCGEE, Mr. CANNON, Mr. HART, Mr. BARTLETT, Mr. LONG of Hawaii, Mr. BURDICK, Mr. SMITH of Massachusetts, and Mr. LONG of Louisiana) introduced the following bill; which was read twice and referred to the Committee on Banking and Currency

# A BILL

To assist in the promotion of economic stabilization by requiring the disclosure of finance charges in connection with extensions of credit.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That this Act may be cited as the "Truth in Lending Act".

4 DECLARATION OF PURPOSE

5 SEC. 2. The Congress finds and declares that economic
6 stabilization is threatened when credit is used excessively for
7 the acquisition of property and services. The excessive use
8 of credit results frequently from a lack of awareness of the

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1 cost thereof to the user. It is the purpose of this Act to
2 assure a full disclosure of such cost with a view to preventing
3 the uninformed use of credit to the detriment of the national
4 economy.

5 DEFINITIONS

6 SEC. 3. As used in this Act, the term—
7 (1) "Board" means the Board of Governors of the Fed-
8 eral Reserve System.
9 (2) "Credit" means any loan, mortgage, deed of trust,
10 advance, or discount; any conditional sales contract; any
11 contract to sell, or sale, or contract of sale of property or
12 services, either for present or future delivery, under which
13 part or all of the price is payable subsequent to the making
14 of such sale or contract; any rental-purchase contract; any
15 contract or arrangement for the hire, bailment, or leasing of
16 property; any option, demand, lien, pledge, or other claim
17 against, or for the delivery of, property or money; any
18 purchase, or other acquisition of, or any credit upon the se-
19 curity of, any obligation or claim arising out of any of the
20 foregoing; and any transaction or series of transactions hav-
21 ing a similar purpose or effect.
22 (3) "Finance charge" includes interest, fees, service
23 charges, discounts, and such other charges incident to the
24 extension of credit as the Board may by regulation prescribe.
25 (4) "Creditor" means any person engaged in the bus-

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1 iness of extending credit (including any person who as a
2 regular business practice makes loans or sells or rents prop-
3 erty or services on a time, credit, or installment basis, either
4 as principal or as agent) who requires, as an incident to the
5 extension of credit, the payment of a finance charge.
6 (5) "Person" means any individual, corporation, part-
7 nership, association, or other organized group of persons,
8 or the legal successor or representative of the foregoing, and
9 includes the United States or any agency thereof, or any
10 other government, or any of its political subdivisions, or
11 any agency of the foregoing.
12 DISCLOSURE OF FINANCE CHARGES
13 SEC. 4. Any creditor shall furnish to each person to
14 whom credit is extended, prior to the consummation of the
15 transaction, a clear statement in writing setting forth, to
16 the extent applicable and in accordance with rules and regu-
17 lations prescribed by the Board, the following information—
18 (1) the cash price or delivered price of the property
19 or service to be acquired;
20 (2) the amounts, if any, to be credited as down-
21 payment and/or trade-in;
22 (3) the difference between the amounts set forth
23 under clauses (1) and (2);
24 (4) the charges, individually itemized, which are
25 paid or to be paid by such person in connection with the

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1 transaction but which are not incident to the extension
2 of credit;
3 (5) the total amount to be financed;
4 (6) the finance charge expressed in terms of dol-
5 lars and cents; and
6 (7) the percentage that the finance charge bears
7 to the total amount to be financed expressed as a simple
8 annual rate on the outstanding unpaid balance of the
9 obligation.

10 REGULATIONS

11 SEC. 5. (a) The Board shall prescribe such rules and
12 regulations as may be necessary or proper in carrying out
13 the provisions of this Act. Any rule or regulation prescribed
14 hereunder may contain such classifications and differentia-
15 tions, and may provide for such adjustments and exceptions
16 as in the judgment of the Board are necessary or proper to
17 effectuate the purposes of this Act or to prevent circum-
18 vention or evasion, or to facilitate the enforcement of this
19 Act, or any rule or regulation issued thereunder. In pre-
20 scribing any exceptions hereunder with respect to any par-
21 ticular type of credit transaction, the Board shall consider
22 whether in such transactions compliance with the disclosure
23 requirements of this Act is being achieved under any other
24 Act of Congress. The Board shall exempt those credit
25 transactions between business firms as to which it deter-

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1 mines adherence to the disclosure requirements of this Act
2 is not necessary to carry out the purpose of this Act.
3 (b) In the exercise of its powers under this section,
4 the Board shall request the views of other Federal agencies
5 exercising regulatory functions with respect to creditors, or
6 any class of creditors, which are subject to the provisions of
7 this Act, and such agencies shall furnish such views upon
8 request of the Board.

9 EFFECT ON STATE LAWS

10 SEC. 6. (a) This Act shall not be construed to annul,
11 or to exempt any creditor from complying with, the laws of
12 any State relating to the disclosure of information in con-
13 nection with credit transactions, except to the extent that
14 such laws are directly inconsistent with the provisions of
15 this Act.
16 (b) The Board shall by regulation except from the re-
17 quirements of this Act any credit transactions or class of
18 transactions which it determines are effectively regulated
19 under the laws of any State so as to require the disclosure
20 by the creditor of the same information as is required under
21 section 4 of this Act.

22 PENALTIES

23 SEC. 7. (a) Any creditor who in connection with any
24 credit transaction fails to disclose to any person any infor-
25 mation in violation of this Act or any regulation issued

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1 thereunder shall be liable to such person in the amount of
2 $100, or in an amount equal to twice the finance charge
3 required by such creditor in connection with such transac-
4 tion, whichever is the greater, except that such liability
5 shall not exceed $2,000 on any credit transaction. Action
6 to recover such penalty may be brought by such person
7 within one year from the date of the occurrence of the viola-
8 tion, in any court of competent jurisdiction. In any action
9 under this subsection in which any person is entitled to a
10 recovery, the creditor shall be liable for reasonable attorneys'
11 fees and court costs as determined by the court. As used in
12 this subsection, the term "court of competent jurisdiction"
13 means either any Federal court of competent jurisdiction
14 regardless of the amount in controversy or any State court
15 of competent jurisdiction.

16 (b) Except as specified in subsection (a) of this sec-
17 tion, nothing contained in this Act or any regulation there-
18 under shall affect the validity or enforceability of any con-
19 tract or transaction.

20 (c) Any person who willfully violates any provision of
21 this Act or any regulation issued thereunder shall be fined
22 not more than $5,000 or imprisoned not more than one
23 year, or both.

24 (d) No punishment or penalty provided by this Act
25 shall apply to the United States, or any agency thereof, or

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1 to any State, any political subdivision thereof, or any agency
2 of any State or political subdivision.

3 (e) A final judgment hereafter rendered in any criminal
4 proceeding brought by or on behalf of the United States
5 under this Act to the effect that a defendant has willfully
6 violated this Act shall be prima facie evidence against such
7 defendant in an action or proceeding brought by any other
8 party against such defendant under this Act or by the
9 United States under this Act as to all matters respecting
10 which said judgment would be an estoppel as between the
11 parties thereto.

12 EFFECTIVE DATE

13 SEC. 8. This Act shall become effective on January 1,
14 1963.

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87TH CONGRESS
1ST SESSION

# S. 1740

# A BILL

To assist in the promotion of economic stabilization by requiring the disclosure of finance charges in connection with extensions of credit.

By Mr. DOUGLAS, Mr. PROXMIRE, Mrs. NEUBERGER, Mr. CLARK, Mr. LAUSCHE, Mr. CASE of New Jersey, Mr. MAGNUSON, Mr. JACKSON, Mr. YARBOROUGH, Mr. YOUNG of Ohio, Mr. MCNAMARA, Mr. CHURCH, Mr. MORSE, Mr. GRUENING, Mr. MCGEE, Mr. CANNON, Mr. HART, Mr. BARTLETT, Mr. LONG of Hawaii, Mr. BURDICK, Mr. SMITH of Massachusetts, and Mr. LONG of Louisiana

APRIL 27, 1961

Read twice and referred to the Committee on Banking and Currency

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A. WILLIS ROBERTSON, VA., CHAIRMAN

JOHN SPARKMAN, ALA.
PAUL H. DOUGLAS, ILL.
JOSEPH S. CLARK, PA.
WILLIAM PROXMIRE, WIS.
HARRISON A. WILLIAMS, JR., N.J.
EDMUND S. MUSKIE, MAINE
EDWARD V. LONG, MO.
MAURINE B. NEUBERGER, OREG.
WM. A. BLAKLEY, TEX.

HOMER E. CAPEHART, IND.
WALLACE F. BENNETT, UTAH
PRESCOTT BUSH, CONN.
J. GLENN BEALL, MD.
JACOB K. JAVITS, N.Y.

MATTHEW HALE, CHIEF OF STAFF

United States Senate

COMMITTEE ON BANKING AND CURRENCY

July 5, 1961

Hon. William McChesney Martin, Jr.
Chairman, Board of Governors
Federal Reserve System
Washington 25, D. C.

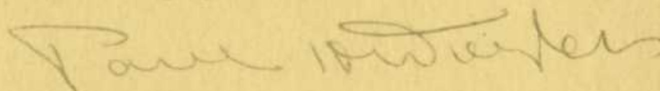
My dear Mr. Chairman:

Hearings on S. 1740, the "Truth in Lending" bill, will begin on July 17. Your appearance to present the views of the Board of Governors of the Federal Reserve System would be an important part of the hearing record.

I understand that the staff of the Banking and Currency Committee has conferred with Mr. Shay and that you would be able to testify before the Production and Stabilization Subcommittee on Wednesday, July 19, at 10:00 A.M.

It would be most helpful if one of your staff experts in the field of consumer credit would appear with you to answer more detailed and technical questions which might arise during the presentation of the Board's views.

Sincerely yours,



Paul H. Douglas
Chairman, Subcommittee on
Production and Stabilization

PHD:lc

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July 6, 1961.

Dear Wallace:

Thank you for sending me the interesting statement you made on the floor of the Senate on the "Truth in Lending" bill.

I am very glad to have this and I also got out of our Library Robert Johnson's "Methods of Stating Consumer Finance Charges," and found it very interesting indeed. We will do our best with this matter and appreciate your bringing the problems to our attention.

With all good wishes,

Sincerely yours,

(Signed) Bill

Wm. McC. Martin, Jr.

The Honorable Wallace F. Bennett,
United States Senate,
Washington 25, D.C.

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WALLACE F. BENNETT
UTAH

L. RALPH MECHAM
ADMINISTRATIVE ASSISTANT

# United States Senate

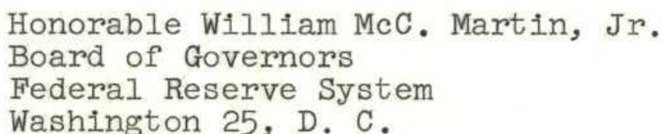
WASHINGTON, D. C.

COMMITTEES:
FINANCE
BANKING AND CURRENCY

JOINT COMMITTEES:
ATOMIC ENERGY
DEFENSE PRODUCTION

Mr Shay

June 27, 1961


Honorable William McC. Martin, Jr.
Board of Governors
Federal Reserve System
Washington 25, D. C.

Dear Bill:

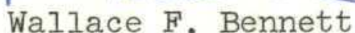
Confirming our telephone conversation last night, I am enclosing a copy of the statement I made about the Douglas "Truth in Lending" bill, S. 1740, frankly in the hope that you will express a somewhat similar attitude toward this bill in the statement that you have been called upon to make for the Committee.

I realize you have to be professional and objective and I don't, but I think this bill represents a very serious problem.

It was good to talk to you.

Sincerely,

Wallace


Wallace F. Bennett

WFB:sq

Enc.

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SPEECH DELIVERED BY SENATOR WALLACE F. BENNETT (R-UTAH)
SENATE FLOOR
MAY 3, 1961

FOR RELEASE ON DELIVERY

# THE TRUTH ABOUT THE "TRUTH IN LENDING BILL"

Last Thursday the Senior Senator from Illinois, Mr. Douglas, introduced what he called the "Truth in Lending" bill, and he and Senators Proxmire of ~~Pennsylvania~~ Wisc. and Neuberger of Oregon spoke in support of it.

Those who embark on a crusade in the name of truth take on themselves a great moral obligation. They must search for truth diligently with open minds---minds that are not so prejudiced that they reject, oppose, or ignore all facts that do not fit into their conceived goal or purpose. That is certainly required of us in Congress; and if we are to find truth in anything, including truth in lending, we must maintain truth in legislation.

Is this bill, S. 1740, conceived and supported in the clear spirit of truth? Do its requirements meet its stated objectives? Are the examples used and the arguments made to support it clearly relevant, internally consistent, and free from concealed purpose? Speaking as a member of the Subcommittee on Banking and Currency, which heard a similar bill last year, my answer to all of these questions would be an unqualified "No." It will take many hours of testimony and

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questioning in the Committee to bring out all the evils buried in this bill; but from last year's hearings, this year's text and last Thursday's opening statements, we can easily discern what to look for.

Last year its author called it the Finance Charge Disclosure Act. This year, with a flourish, he rechristened it the "Truth in Lending Bill." I could suggest a few other titles which seem to me to be more appropriate. For instance, if Perry Mason were naming it, he might very well call it "The Case of the Cross-Eyed Credit Controls" because its stated objective looks toward one goal and its key provisions toward another. Another phrase that suggests itself is "Nonsense and Non Sequitur" because the bill would not affect most of the evils described in the "horrible examples" used to arouse emotional support for it, and its key provisions are, in my opinion, incapable of being understood, complied with or enforced. Resorting to a bad pun, I have called this whole procedure the Hidden Bill Trick. That this designation fits is evident all through the bill.

First, the language which describes the stated objective of the bill conceals the true purpose.

Second, it also may conceal an anti-business bias, including an apparent belief that businessmen must be immoral, ipso facto.

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Third, the lurid examples, presented in the testimony, actually involve fraud and other crimes which are already punishable by local law.

Fourth, the language of the bill hides a hoax, because the bill as it is written cannot be enforced without also setting up and using vast new Federal powers to change the whole pattern of our present system of using credit in retail distribution, and to fix prices on every commodity and service in every town in the United States.

Fifth, our search for truth should lead us to try to discover whether there is any justification for legislation in this field at the Federal level. Have the states been asleep to the desirability of accurate, workable laws to provide truth in lending?

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Sixth, and finally - we come to the question which should have basic and ultimate concern for all of us, who, as I said at the beginning, should be dedicated to truth in legislation. Is the bill constitutional?

Let's start at the beginning with the objective. Does it state great truth - or, in fact - is it true at all? Let me read again - It claims that the Congress finds and declares that

> "economic stabilization is threatened when credit is used excessively for the acquisition of property and service. The excessive use of credit results frequently from a lack of awareness of the cost thereof to the user. It is the purpose of this Act to assure a full disclosure of such cost with a view to preventing the uninformed use of credit to the detriment of the national economy."

This premise is at best highly debatable. Not a single line of testimony was presented to support this proposition at hearings on a similar bill last year. On the contrary there was opposite testimony by Professor Theodore N. Beckman, Professor of Marketing at Ohio State University. He presented official statistics demonstrating that consumer debt had shown a very stable relationship to Gross National Product and Personal Disposable Income during the preceding four years. His data also showed that rates of repayment had maintained a sensible relationship to new extensions of credit during the same period. His testimony was uncontradicted.

Furthermore, Federal Reserve Board officials concerned with consumer credit have flatly refused to commit themselves to any specification of a safe or unsafe ratio of consumer debt in relation to personal income or any other economic yardstick. So far as the record shows, consumers are better managers of their own credit problems than the sponsors of this bill would have the Congress believe. Certainly I have seen nothing to warrant a

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congressional endorsement of the first bland assumption made in the Declaration of Purpose of this bill.

Now let's look at the bill's stated objective again in terms of its proposed solution - are the two inherently related - or is this a great non sequitur?

In the first line it says Congress finds and declares that economic stabilization is threatened when credit is used excessively for the acquisition of property and services. Have we found that? Is our Gross National Product, which is the total of goods and services, too high? Should we be working to cut it down? The bill suggests this, but doesn't say specifically. If there is an excess of credit in this country, how great is it? And if this excess threatens economic stabilization, how shall we eliminate it? The bill doesn't attempt to set standards for proper credit volume, but says "this frequently results from a lack of awareness of the cost thereof to the user." Is this a valid reason? If so, is it the only reason? Or, the chief one? If the bill is passed, could we expect to have greater economic stability?

Or would we have economic chaos?

The plain inference of the bill is that there is now excessive credit in our distribution system which must be taken out. Where? Exanples given point to durable goods such as automobiles. By how much is automobile credit excessive? If we take this excess out - by how much

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will we add to the unemployment in Michigan? The same question can be asked for any industry whose products are bought on credit. Underlying this bill is an ancient myth which assumes there is a limit of virtue in interest rates, and that this is set at 6%. The corresponding inference is that every finance charge above 6% is immoral. Could we apply this yardstick to all credit transactions and improve the stabilization of the economy? The truth is that if all consumer credit transactions above 6% were considered excessive, and therefore had to be eliminated, our whole present economic system of mass distribution, instead of being stabilized, would collapse. The truth is that most, if not all, of our retail transactions involving delayed time payments include other factors, the total cost of all of which far exceeds a 6% simple annual rate. S. 2755, introduced in the last Congress, required that all charges for credit be totaled and stated as "simple annual interest". To have done this would be to require a statement that is patently untrue; since interest, the cost of the use of money, is only one part of the cost of retail credit, which is usually unsecured. In order to provide credit to his customers, the retailer must himself borrow money at prevailing interest rates. In addition, he must incur other costs, including the expense of checking credit, keeping records, cost of making collections, and the burden of bad debt losses, to name only a few - of a myriad of small transactions.

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Actually the sum of other costs which are required to provide "on-the-spot" time payment credit service for retail purchases is several times greater than the cost of the interest component.

A fundamental "Truth in Lending," which the sponsors of this bill seem incapable of learning, is that the cost of providing retail merchandise credit, repayable in small installments at the customer's convenience, ranges from 12 to 18 percent per annum -- the actual prevailing charges of reputable merchants.

The real cost of providing consumer credit is of course reflected by the numerous state small loan laws. They authorize rates of 2 to 3 percent per month. In passing, it is significant to note that these laws require only disclosure of the applicable monthly rates, not the annual rates of 24 to 36 percent per year. I believe this, too, traces to the 6 percent myth, which would drive consumers to unlicensed loan sharks operating on a larcenous lump sum basis, in the mistaken belief that it was cheaper than interest at 24 percent per year.

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The reasonableness of an 18% annual finance rate for retail merchandise credit, in the light of related costs, was affirmed by a proponent of the bill, former Congressman Voorhis. He is Executive Director of the Cooperative League of the United States of America. This is what he testified, and I quote:

> ". . .I know that retail stores have to charge monthly charges on credit accounts probably because it is a costly proposition. I also expect they do not maybe even cover that cost and that the people who pay cash are subsidizing the people who are getting the credit in many cases."

* * *

> "And I want to try to make it clear that I am not blaming the retail stores for charging 1-1/2 percent." (per month)

A banker witness, who testified for the bill, said the same thing. Speaking of retail credit charges, Mr. Herbert E. Cheever, Vice President of the First National Bank of Brookings, South Dakota, said:

> "...There are transactions certainly where 1-1/2 percent per month would not be exorbitant, depending upon the risk and the amount of the transaction".

Official statistics prove that he is right and undermine any contention that retail merchants are using credit charges as a device to exploit consumers. According to Internal Revenue Service figures included in the record of last year's hearings, the retail industry's after-tax earnings in 1957-1958 were only 2% of sales and 6.2% of assets. Comparable figures for manufacturing industries during the same period were 7% and 10.1% respectively.

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The prevelance of the 6% notion was affirmed by credit union representative Donald J. MacKinnon of the Ford Dearborn Federal Credit Union, who testified, and I quote:

> "...We have even been accused of usurious practices when we tell a member that we charge 12 percent per annum..."

Now lets see what the bill will do in the light of these facts. The irrelevant "horrible examples" contained in last year's hearings, and the uninformed editorials they inspired, some of which were put in the Record last Thursday, reveal an unwarranted attempt to besmirch the image of all retailers, big and little, who sell on credit. In his speech on Thursday, on page 6415 of the Record, Senator Douglas says he is not trying to indict the American business community, but he also says the consumer does not get true and accurate information from them (businessmen) about credit. He then implies that they can't be expected to have any morals because they "have fallen into a business jungle where survival seems to have depended on camouflaging, hiding, or understating the real price of credit." This bill is supposed to release them from that bondage. I claim that there is no such jungle now, but that this bill would create one. Where is the truth?

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Let me put this problem in the framework of the bill before us, S. 1740. Let's assume that the Douglas Bill is enacted and the reputable retail merchants advertise credit charges of 15 to 18% on the basis of simple annual rates. What will be the reaction of the credit exploiter who is the assumed target of the bill? I can envision the ads now.

"WHY PAY 15% OR 18% FOR CREDIT? BUY HERE AND GET 24 MONTHS TO PAY WITHOUT ANY CREDIT CHARGE."

The very enactment of this bill and the attendant publicity on the importance of percentage rates would put a premium on such advertising. Nothing in the bill could stop such advertising because every merchant is free to absorb his credit costs in price, if he so chooses. And what will the legitimate merchant do in the face of such competition? The answer is plain. He will have to follow suit. For the average consumer will mistakenly assume that the merchant who advertises the true annual cost of credit -- 15% to 18% -- is the exploiter while his benefactor is the merchant who provides credit without charge. Precisely those consumers who are presently susceptible to exploitation by way of excessive credit charges will be the first to patronize the merchant who advertises no charge for credit.

The unfortunate fact is that because of public conditioning, the communication to consumers of an 18% annual rate would penalize the merchant who gave the message. Let me quote a witness who appeared at the behest of the Senator from Illinois. I refer to

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Professor Morse of Kansas State University. These are his words:

> "Yes, this seems to be the market truth. That is, one would be at a competitive disadvantage to state the truth, the true rate of interest under prevailing conditions."
>
> * * *
>
> "It would appear to be quite disastrous to be quoted at 12 percent or 18 percent et cetera".

You can't escape the plain answer that in a competitive economy such as ours no merchants can afford to state actual annual rates unless all merchants do so. And I repeat there is nothing in this bill that can require all merchants to do so. On the contrary, adoption of this bill would encourage the very thing at which it is aimed. It would put a premium on deceptive pricing and advertising practices by the small group of unscrupulous credit merchants and in the long run force such practices on the great body of legitimate business.

So passage of this bill will not affect the exploiters; less, not more, credit information will be furnished the public; and beyond this, cash customers will be saddled with hidden credit costs. Let there be no mistake about these inevitable consequences of this bill. They are bourne out by the testimony of witnesses favoring the legislation at last year's hearings.

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Let there be no mistake either about the decency of the credit practices of the overwhelming majority of American businessmen. The record of last year's hearings is equally clear on this. Again I refer to the testimony of witnesses who supported the bill. Mr. MacKinnon of the Ford Credit Union said:

> ". . . I simply do not agree with those who believe that a large proportion of the people who charge rates of interest in excess of our own, are guilty of usurious practices, or in any way deliberately attempting to defraud the public. It is my experience that the vast majority of those in the personal credit business are honest and upright citizens. Of course, there are the fringe operators who bring disrepute to any business but they operate largely outside or without benefit of legal control and are in no way representative of the great majority of ethical firms doing business in this country."

Mr. MacKinnon was not alone in commending the vast body of American merchants for their ethical credit practices. Other witnesses for the bill affirmed the same thing. President Buckmaster of the United Rubber Workers stated:

> "The overwhelming majority of our business establishments are dedicated to the good economics of fair and honest dealings. This bill strikes only at the unscrupulous few who give business in general a bad name."

Mrs. Alice Thorpe, representing the American Home Economics Association, testified similarly and criticized only

> ". . . the few who, in one disguise or another, cloak excessive charges and advertise in glowing terms so that the uninformed person is not able to distinguish between the legitimate costs and padding, so to speak."

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Even the distinguished Senator from Wisconsin, a co-sponsor of the bill, recognizes the unfairness of comparing the credit charges of retail merchants or commercial lenders with those of cost-free and tax-exempt credit unions. He said during last year's hearings:

> "Of course, I am a great advocate and supporter of credit unions. They have their national headquarters in Wisconsin. But in all fairness, we have to recognize they do not operate on the same basis as the commercial loaning operation."
>
> "They do not have the same charges at all, have all kinds of privileges that the commercial operation does not have. And the competition, therefore, is really not very fair."

Apart from everything else I have said, the fact is the bill wouldn't help consumers in the slightest, even if it were feasible and enforceable. The truth is that consumers are uninterested in annual percentage rates and could not use the information if it were provided. In this connection, I cite the following testimony of the President of the National Association of Better Business Bureaus, who appeared at the invitation of the Subcommittee Chairman:

> "I have a great deal of doubt in my own mind from talking to thousands of customers over the years that they are particularly interested in what the so-called interest rate is in the installment contract. They are interested in what the dollar cost is and how much it is going to cost them per month to pay the balance which they have obligated themselves for."

Of course, he is right. Consumers are interested in how their dollar expenditures will fit within their budgets, not in abstract annual rate concepts which may be of importance to bankers and large investors.

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On the uselessness of percentage rate information to customers, let me refer you to the statement of Duncan Holthausen at last year's hearings. He is a former credit official of the Federal Reserve Board and is now the operator of a small family department store in Union City, New Jersey. Addressing himself to the claim that percentage information would enable consumers to compare credit costs, he demonstrated that this idea was illusory, even in the case of identical merchandise. Again I quote:

> "Of course, basic to this whole discussion, is the assumption that consumers can tell which is the 'better buy' if given price and interest rate. Is a 1960 Brand X car for $3,200 at 18 percent simple annual interest with 24 months to pay a 'better buy' than the same 1960 Brand X car for $3,300 at 15 percent simple interest with 24 months to pay? I am sure few consumers could give this answer. Professor Morse, in a college level family finance course, finds it necessary to spend '2 weeks' dealing with 'minute calculations' of consumer credit arithmetic -- in other words, the problems of relating credit costs to simple annual interest. How can we expect the average consumer to relate simple annual interest to dollars, if it takes 2 weeks of intensive study on the part of college students?"

How many members of this body could make the computations required to answer the question posed by Mr. Holthausen and how long would it take?

Having shown my great doubt that there is any truth in the relationship between the stated objective of the bill and its requirements, and my feeling that the evil image of the American retailer which the bill projects is not accepted by the public, as evidenced by those witnesses who supported the bill in last year's hearings, let us turn now to consider the problem of complaince and enforcement with their inevitable effects on our whole retail distribution system.

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Anyone with even meagre experience in retailing can easily see why the bill is so misleading and deceptive. Its major provision is a requirement that no merchant can regularly sell goods on credit unless he informs each customer in advance of the credit charge expressed in terms of a simple annual percentage rate. The claim is that this will insure the disclosure to the public of the real cost of consumer credit. This claim is deception itself. The bill will not and, as I have already said, cannot accomplish any such purpose. It would lead instead to suppression of the cost of credit.

The reason is that as the bill is written, the annual rate requirement can neither be enforced, nor observed, except upon two intolerable conditions.

The first is federal regulation of the methods and procedures by which merchants may extend credit. Even the author of the bill denies this purpose.

The second is the establishment of a full-blown federal price control agency to fix maximum cash ceiling prices for every merchant and on every item in every corner of the United States, and to compel the separate statement of the percentage credit rate.

The proponents of the bill have maintained a discreet silence on these points, and although price control may not be the ultimate objective of the bill, it is meaningless without such control. This silence is understandable because it hides the unpalatable truth.

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I can't conceive that any member of the Congress dedicated to a free enterprise economy would support nationawide credit and price controls in peacetime. Too many of us remember the huge price control agencies of World War II and the Korean War and the burdens they imposed on business and the consuming public alike.

The futility of the bill as it stands needs no intricate explanation. The point is simply that without such supporting credit and price control regulation, no merchant in the land would have to suffer the burden of stating credit charges in terms of annual rates. He would be free to fix his prices at levels which would take care of his credit costs and could remain free to advertise to consumers that he made no charge for credit, no matter how long the period of payment was extended.

This is no figment of my imagination. The point has never been denied, although it was raised during last year's hearings by the General Counsel for the National Small Business Men's Association. This is what he told the Subcommittee:

> "If we embark on this course we can fully expect to pay the penalty of Federal price control."
>
> "The whole concept of our economy, particularly the anti-trust laws, is aimed at preserving the freedom of each businessman to fix his own prices. This is basic to our economic system. Consequently, any merchant would be free to fix whatever cash price he chose and to advertise whatever credit costs for time payment he saw fit. The only way this inherent weakness of the bill could be over-come is by adding to it provisions which either fixed maximum cash prices, and compelled a separate statement of the charges for time sales, or which compelled the dis-closure, in addition to credit charges, of the merchant's wholesale costs and his selling expenses for the goods he retails. I do not think anyone here would want to see the

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> kind of national agency which would be needed to administer a bill of that kind."

As a matter of fact, if this bill were passed, every merchant in the land would be under heavy pressure to set his prices so as to avoid any separate credit charges. And this could easily be done. As I have said, it would only be necessary to absorb credit costs in base price in the same way as other overhead costs, such as advertising, rent and labor costs, are now so absorbed.

In fact, the bill will force this result for at least three reasons. First, it is actually impossible to comply with the simple annual rate requirement in the light of commercial realities. In the vast majority of merchandise credit transactions, it is impossible to know in advance what the simple annual credit rate will be. This is true of the most popular form of retail credit in use today known as the revolving charge account. It is also true of the familiar kind of retail installment account known as the add-on account.

In these, as well as other types of retail credit procedures, a simple annual rate cannot be forecast because it is not known at the time of the original transaction how long the customer will use his credit and how much credit he will use over any defined period.

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This failure of the bill to recognize the realities of commercial life was attested by an expert federal agency during last year's hearings. With reference to similar problems encountered in the home loan field, the Chairman of the Federal Home Loan Bank Board wrote the Chairman of this Committee as follows:

> ". . . it is not apparent how it would be possible to comply with the terms of the bill requiring a statement of the total amount of the finance charges and the percentage that such amount bears to the balance, expressed in terms of simple annual interest."

S. 1740 asks the Congress to ignore these elementary commercial facts. This is legislative irresponsibility. It departs from the experience and action of the numerous state legislatures which have already acted in this field. In fact, at least 31 states have passed laws dealing with various types of merchandise credit, including measures establishing maximum rates and compelling comprehensive disclosure of consumer credit charges, but in dollars or monthly rates of service charge. They have acted responsibly. They have known better than to saddle the merchants of America with the impossible liability inherent in the simple annual requirement of this bill.

In the second place, if simple annual rates could be somehow calculated, the requirement would be intolerably onerous, burdensome, and expensive. There would be laborious paper work every time a credit sale was made. "Simple" sounds simple, but it isn't. It would be, if all contracts were to run for an even year,

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with payments to be made in equal installments at equal time intervals. But few contracts are written that way. They are generally written for periods shorter or longer than a year, with payments weekly, bi-weekly or monthly, often with no payment for the first month or two of the contract, or with smaller payments at first and larger payments at the end, or with a provision for skipped payments or with many other variations, all of which affect the interest rate, and make the computation of that rate extremely complex.

To illustrate, consider an example presented at the previous hearings by one witness. A man, caught in an emergency, wants to buy a $20 battery at a gas station, and wants to pay for it on time. The carrying charge is $2. He buys the battery on a Monday, and wants to begin payments on the following Friday, which is his payday. He is paid every other week, so he makes four bi-weekly payments of $5 each, with a final payment two weeks later of $2. How much "simple annual interest" does the $2 represent?

I took this problem home that evening, and after a couple of hours came up with three different answers, 94 per cent, 101 per cent, and 104 per cent, depending upon what assumptions are made about the proportion of each payment going to principal and interest. Next day, I asked a member of my staff, an economist, to compute it. He spent half an hour on it, but didn't have the formula he needed, so he referred it to the Library of Congress.

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After an hour's delay, the Library came up with an answer of 129.5 per cent. One of the Committee witnesses, a professor of marketing, worked on the problem for half an hour and came up with an answer of 118.9 per cent. The man who posed the problem in the first place couldn't figure it closer than "between 110 and 130 per cent." A Newsweek article on the hearings and on the problem prompted a few letters to me. Three of these contained new and different answers to the problem. One by a statistical expert for Beneficial Management Corporation brought an elaborate two-page computed solution of 125.33 per cent. The other responses I received were 117.7 per cent and 80 per cent. In light of this variation among the experts as to the correct answer, how can an ordinary retail clerk possibly be expected to find the correct answer? I hope the sponsors of this bill love truth enough to learn it by trying to figure one of these "simple" problems for themselves as I did last year.

Let me point out also that rate books offer no solution. Because of the infinite variety of retail prices and credit terms, such books would have to assume the proportions of the New York City Telephone Directory. Their accurate use would require the services of trained experts and hours of time, and there would still be more than two-thirds of the retail credit transactions which such books could not cover.

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The impact of this bill is not confined to professional financial institutions or even to large retail institutions. It would reach credit transactions in every town and crossroads of America. It would cover the credit transactions between the grocer and the housewife; between the corner filling-station operator and the local motorist. It is as broad in its sweep as the wartime Price Control Acts. Imagine a rural hardware dealer on a busy Saturday afternoon taking time to make the required calculations and to fill out voluminous forms every time he made a sale on credit to a farmer. Imagine a housewife making five separate purchases in five sections of a department store and having to wait for a credit rate calculation from each sales girl who waited on her. Yet this is exactly what the bill would require.

From what I have said, it is apparent that the bill is of unprecedented scope for Federal legislation. In this connection I remind the Senate of the widespread concern about the intrusion into local affairs contemplated by the recently passed Senate amendment to the Fair Labor Standards Act. This bill goes much further. If verification is needed, I cite the statement of the Chairman of the Federal Trade Commission during last year's hearing on the bill. In his words

> "the bill goes far beyond the scope of Commission jurisdiction in that it contains no interstate or foreign commerce limitation."

The impossible enforcement and compliance problems were enough to cause the Chairman of the Federal Reserve Board to back

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away from the administrative responsibility. He advised the Chairman:

> "Extension of the Board's duties into the field of fair trade practices as contemplated by this bill would be foreign to the Board's present responsibilities."

It is no wonder that the Federal agencies suggested as the possible enforcement agency at last year's hearings politely declined the honor. Even the distinguished Senator from Pennsylvania, whose name appears on the bill, is aware of the dismaying enforcement problems. During last year's hearings, he said

> "I would like to say I can see why the Federal Reserve does not want this administrative job. It is the job I do not think anybody would want."

Let us now consider whether the emotional supporting testimony presented at last year's hearing was either relevant to this bill, or indicative of any need for Federal legislation to control consumer credit. During those hearings, a parade of "horror stories" of consumer exploitation was presented to the Subcommittee. Heart-rending tales of episodes in which unscrupulous salesmen made exhorbitant credit charges or palmed off shoddy merchandise on people of low income, some of them illiterate, were told on the record presumably to give a surcharged dramatic background to the proposal. However, most, if not all, of these were cases of plain fraud and deception which would not be covered or controlled by this proposal and should better be left to the states and local communities. This kind of consumer exploitation

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by a few unscrupulous merchants does not justify the extension of Federal dominion over the millions and millions of transactions that occur everyday in the market place. State and local enforcement agencies already have the power to cope with this problem and deal severely with this type of fraud. The Federal Reserve Board, the Federal Trade Commission or any other Federal agency should not be required to exercise police power over the billions of local retail transactions in our economy.

Is there any justification for Federal legislation of any kind in this area? Have the states ignored their responsibility? The record is clearly the opposite. The truth is that many states have already dealt realistically and effectively with various phases of this problem, including maximum rates and disclosure, and others can be expected to follow. Let's take another look at the record of last year's hearings. This is what President Nyborg of the Association For Better Business Bureaus told the Committee:

> "There is no question about the fact that many of the States have moved and others are considering moving in various ways to afford protection at the State level."

He is absolutely right. All states have laws covering the lending activities of banks. In addition, forty-two states have laws requiring the disclosure of credit charges on small loans; thirty-one states regulate automobile installment sales; and eighteen states cover installment

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sales of other types of goods as well as automobiles. And in the new area of revolving charge accounts, seven states have already passed laws, while such legislation is under active study in a number of other states. All indications demonstrate that the state governments are alert to the needs in this area and are going ahead with adequate legislation.

To me, this evidence is conclusive. Most state laws have been enacted in recent years. In other words, the current trend is for more and more states to meet the problem, thus making federal regulation unnecessary. Before 1940 only three states (Indiana, Michigan and Wisconsin) had special legislation covering installment credit. Three more joined this group between 1941 and 1945 (California, Maine and Maryland). In the 1946-1950 period, Michigan basically changed its statutes and four new states passed installment credit laws (Connecticut, New Jersey, Ohio and Pennsylvania). Between 1951 and 1955, Colorado, Nevada and Utah were added in the installment statute goup. Then in the four-year period of 1956-1959, <u>seventeen</u> states passed their first special installment credit laws. In 1959 alone <u>nine</u> states either passed their first statutes in this area or amended old ones. In total, there were about one thousand legislative proposals made in state legislatures during that year. In fact state laws protect consumers today in the nation's heaviest population areas. In addition, the states of Iowa, Maryland, Massachusetts, and Pennsylvania have established commissions to study installment selling. There is an impressive record of

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performance on the state level. And it cannot be suggested that the state laws are dead letters. On the contrary, these laws are effective. The President of the National Association of Better Business Bureaus, Mr. Nyborg, affirmed this in answer to a pointed question from Senator Bush. Let me read you their exchange:

> Senator Bush: "You think then that the consumer and the average citizen is getting all the legal protection that he needs in connection with this matter of disclosure in the State of New York?"
>
> Mr. Nyborg: "It seems to me that this is the case, yes."

And his testimony was corroborated by Mr. William Kirk, representing the Union Settlement House of New York, who told the Committee:

> "I think it is very clear that where people in our community go down to established stores they are given complete information in every way that conforms with the law."

There is in short no reasonable basis for disregarding the advice of the Federal Deposit Insurance Corporation to Chairman Robertson that

> ". . .this is a field of activity that should be appropriated by the State and local governments to govern and police."

We come now to the last and ultimate question. I am not a lawyer and thus have not attempted any analysis of the legality or constitutionality of the bill. But I would point out that it contains criminal as well as civil sanctions. Speaking as a layman, I will only say that from a purely common-sense standpoint, it seems to me that the Congress ought not inflict the business community of America with any legal liability on the basis of a

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measure so unrealistic, so unnecessary, and so uncertain in its application and requirements. If this proposal is based on the interstate commerce clause of the Constitution, it extends this clause far beyond its present limits, including the recent extension of the Fair Labor Standards Act to the retail trade.

For all of these reasons I have considered it my duty to urge the Congress to be especially watchful of this legislation. Its alleged banner of truth is a tempting one to follow. But this truth label is a deceptive cover for a misleading package -- a hidden bill trick. The bill will not lead to "Truth in Lending". It will produce exactly the opposite result. The Congress is being asked to enact a bill which is absolutely unenforceable as it stands and which, however, amended, could not be enforced except with the aid of a vast army of federal price control bureaucrats. Its adoption could only lead to widespread evasion and disrespect of law like the late and unlamented NRA of the early 1930's. If rigid enforcement of S. 1740 were attempted it would burden the taxpayer with the heavy cost of a super-snooper agency, bring both weakness and chaos to our credit-based system of retail distribution, and lessen, rather than increase, the consumer's knowledge of "Truth in Lending". On these issues I hope Senators Douglas, Proxmire and Neuberger will join me in the search for truth at the forthcoming hearings. If they do so sincerely, I have no doubt of the outcome.

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cc Martin

JUL 6 1961

The Honorable A. Willis Robertson,
Chairman,
Committee on Banking and Currency,
United States Senate,
Washington 25, D. C.

Dear Mr. Chairman:

This is in response to your request of April 28, 1961, for a report on S. 1740, a bill "To assist in the promotion of economic stabilization by requiring the disclosure of finance charges in connection with extensions of credit."

The bill would require a person engaged in the extension of credit to furnish to the person to whom credit is extended, prior to the consummation of the transaction, a statement in writing setting forth, to the extent applicable and in accordance with rules and regulations prescribed by the Board of Governors of the Federal Reserve System, among other items, (1) the finance charge expressed in dollars and cents, and (2) the percentage that the finance charge bears to the total amount to be financed expressed as a simple annual rate on the outstanding unpaid balance of the obligation.

As stated in our report on S. 2755, a similar bill introduced in the Congress last year, the Board is in full accord with the objective of requiring lenders and venders to tell the truth about interest rates and finance charges. The regulation of trade practices in stating credit charges, where necessary to prevent deception of borrowers, surely is a desirable social objective.

We also pointed out, in our report last year, that extension of the Board's duties into the field of trade practices as contemplated by the bill would be foreign to the Board's present responsibilities, which are principally in the field of monetary and credit regulation through the banking system. We reaffirm the position we took last year that the administration of such legislation would not constitute an appropriate activity for the Federal Reserve System.

Regarding the effect of disclosure of finance charges in preventing excessive and untimely use of credit by consumers, the Board's studies indicate that moderation of the cyclical expansion and

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contraction of consumer instalment credit reflects in large part changes in the availability of credit to consumer lenders. Such changes in availability are responsive to general monetary policy and are reflected primarily in the application of more or less restrictive standards or terms rather than in higher or lower finance charges.

Finance charges on consumer credit have not changed greatly over the course of recent business cycles, and consumer borrowers have not appeared particularly responsive to such variations as have taken place. This is not to say that greater consumer awareness of interest rates may not influence the over-all pattern of their spending, but this effect would seem to be more in the nature of a long-run rather than a cyclical change. Greater consumer awareness of interest rates charged by various lenders may also, of course, enable them to make a more rational choice among lenders.

In sum, the Board endorses the objective of requiring adequate disclosure of finance charges, but it feels that it would not be appropriate for the monetary authority to administer what would be, essentially, a trade practices statute.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

FRP:ETC:dac

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Miss Muehlhaus

JUL 11 1961

The Honorable Brent Spence,
Chairman,
Committee on Banking and Currency,
House of Representatives,
Washington 25, D. C.

Dear Mr. Chairman:

This is in response to your request of May 4, 1961, for a report on H.R. 6725, a bill "To assist in the promotion of economic stabilization by requiring the disclosure of finance charges in connection with extensions of credit."

The bill would require a person engaged in the extension of credit to furnish to the person to whom credit is extended, prior to the consummation of the transaction, a statement in writing setting forth, to the extent applicable and in accordance with rules and regulations prescribed by the Board of Governors of the Federal Reserve System, among other items, (1) the finance charge expressed in dollars and cents, and (2) the percentage that the finance charge bears to the total amount to be financed expressed as a simple annual rate on the outstanding unpaid balance of the obligation.

As stated in our report on H.R. 9515, a similar bill introduced in the Congress last year, the Board is in full accord with the objective of requiring lenders and venders to tell the truth about interest rates and finance charges. The regulation of trade practices in stating credit charges, where necessary to prevent deception of borrowers, surely is a desirable social objective.

We also pointed out, in our report last year, that extension of the Board's duties into the field of trade practices as contemplated by the bill would be foreign to the Board's present responsibilities, which are principally in the field of monetary and credit regulation through the banking system. We reaffirm the position we took last year that the administration of such legislation would not constitute an appropriate activity for the Federal Reserve System.

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In sum, the Board endorses the objective of requiring adequate disclosure of finance charges, but it feels that it would not be appropriate for the monetary authority to administer what would be, essentially, a trade practices statute.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

WHY:jac
7/7/61

cc: 5 copies to Hon. Brent Spence
Mr. Shay
Miss Muehlhaus

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**Author:** George Shea

**Article Title:** The Outlook: Appraisal of Current Trends in Business and Finance

**Journal Title:** Wall Street Journal

**Date:** July 10, 1961

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Chairman Martin

July 17, 1961.

To: Board of Governors

From: Jerome W. Shay

Subject: Further testimony on "Truth in lending" bill, S. 1740.

The witnesses before Senator Douglas' Subcommittee this afternoon were Hillel Black, a free-lance writer and author of the recent book, "Buy Now, Pay Later", and Captain Ralph B. Terrill, President, Navy Federal Credit Union.

Most of the questioning of Mr. Hillel was by Senator Bennett, whose objective clearly was to discredit Mr. Hillel. In his testimony, as he did in his book, Mr. Hillel urged enactment of S. 1740. The introduction to the book was written by Senator Douglas, and Senator Proxmire's favorable review of the book appeared in some newspapers. Senator Bennett, I thought, was fairly successful in his efforts to demonstrate that Mr. Hillel is not particularly knowledgeable on the subject covered by S. 1740, and that "Buy Now, Pay Later" is a writing of the "sensational" type.

Captain Terrill's testimony, largely repetitive of his testimony last year on the Douglas bill similar to S. 1740, strongly favored the objective of the bill.

As he did during the morning session of the hearings when James Tobin testified, Senator Bush wanted to know if restoration of consumer credit controls of the Regulation W type would be acceptable as an alternative to S. 1740. The answers this afternoon, as was true this morning, were negative.

Senator Capehart asked whether enactment of S. 1740 might decrease sales or possibly contribute to unemployment if, as was intended, the bill would make consumers more discriminate. The answers seemed to be pure guesswork, i.e., "perhaps", "maybe", "conceivably", etc.

Comments by Senators Proxmire and Clark indicated that they would regard S. 1740 as a measure that would "increase competition" and "foster our free enterprise system."

It was learned this afternoon that, in its report on S. 1740, the Department of Justice has recommended that the protection of interstate commerce be made an explicit basis for the bill. Since that is not the case with the present bill, Justice seriously questioned the constitutionality of S. 1740, although it favored the bill's objective.

Last year the Commerce Department, in reporting on the then current Douglas bill, opposed the measure largely on the ground that it would nullify progress being made in the field by the various States. It is understood that Commerce now "favors the principle" of S. 1740, but, at the same time, makes many so-called "technical" suggestions and qualifications.

cc: Each Board Member and Messrs. Thomas, Knipe, Molony, Fauver, Young, Sherman, Koch, Williams, Hackley, Solomon and Masters.

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Chairman Martin

July 17, 1961.

To: Board of Governors

From: Jerome W. Shay

Subject: Information concerning S. 1740, the "Truth in lending" bill.

Attached is a background statement on the "truth in lending" proposals that have been introduced in the Congress, together with a summary of the current Douglas bill, S. 1740.

While the Board will recall much of this information, it was thought that a brief review--as well as a summary of the bill--might be of interest at this time.

Hearings on S. 1740 begin this morning before Senator Douglas' subcommittee. The Council of Economic Advisers will be the first to testify.

cc: Each Board member, Mr. Thomas, Mr. Knipe, Mr. Molony, Mr. Fauver, Mr. Young, Mr. Sherman, Mr. Koch, Mr. Williams, Mr. Hackley, Mr. Solomon and Mr. Masters.

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SOME BACKGROUND CONCERNING

AND

SUMMARY OF

S. 1740, THE "TRUTH IN LENDING" BILL

Democratic Platform 1960. The Democratic Platform adopted last August endorsed legislation such as S. 1740 in the following words:

> "The consumer. . . has a right to know the cost of credit when he borrows money. We shall enact Federal legislation requiring the vendors of credit to provide a statement of specific credit charges and what these charges cost in terms of true annual interest."

Earlier proposals. In January 1960, Senator Douglas and 17 cosponsors, all Democrats except one, Senator Bush, introduced the first bill in Congress on this subject (S. 2755). Following 8 days on hearings on the bill, Senator Douglas' Production and Stabilization Subcommittee of the Senate Banking and Currency Committee favorably reported S. 2755, with minor amendments, by a vote of 4 to 3, the vote being on party lines. Senator Douglas, however, did not press for action on the bill by the full Senate Banking and Currency Committee because he felt that he lacked the necessary votes for Committee approval.

In its report and testimony on S. 2755, the Board, in effect, favored "truth in lending" as a social and economic objective, but opposed the requirement that the Board administer the bill. Briefly, the Board's opposition was based on the view that the bill regulated "trade practices" and was not a credit control measure.

On the House side last year, Congressman Reuss introduced H. R. 9515, a bill virtually identical with the Douglas bill. Aside from requesting reports from interested Government agencies, however, the House Committee on Banking and Currency gave no consideration to the Reuss bill.

Also on the House side last year, Congressman Oliver (defeated in 1960 for reelection) introduced H. R. 11867, a bill similar to the Douglas-Reuss bills, except that it placed administrative responsibility in the Federal Trade Commission. Because of this latter fact, the Oliver bill was referred to the House Committee on Interstate and Foreign Commerce, which, however, gave the bill no consideration, except to ask for reports from interested Government agencies.

The Board, in effect, submitted an unqualified report favorable to the Oliver bill.

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"Truth in lending" bills in the present Congress. Senator Douglas' current bill, S. 1740, is cosponsored by 22 other Senators, all Democrats. Except for slight changes, S. 1740 is identical with Senator Douglas' bill of last year as reported favorably by his Production and Stabilization Subcommittee.

In his statements concerning his current bill, Senator Douglas has emphasized the economic stabilization feature of the measure, whereas this received virtually no emphasis in his statements last year concerning S. 2755, which he repeatedly characterized as not being a credit control measure. Perhaps a main cause for this shift in emphasis is last year's criticisms of S. 2755 as being of doubtful constitutionality.

On the House side, bills identical with Senator Douglas' current bill have been introduced by Congressmen Multer, Reuss, and Halpern, all members of the House Banking and Currency Committee (H. R. 6725, H. R. 6763, and H. R. 7013). However, except to ask for reports from interested Government agencies on the Multer bill, the House Committee on Banking and Currency has thus far given no consideration to such bills. So far as we know, that Committee has no further plans for the "truth in lending" proposals.

## SUMMARY OF DOUGLAS BILL, S. 1740

Purpose. S. 1740, a bill "To assist in the promotion of economic stabilization by requiring the disclosure of finance charges in connection with extensions of credit," would be cited as the "Truth in Lending Act."

At the onset, the bill states (1) that the excessive use of credit (a) threatens economic stabilization, and (b) frequently results from a lack of awareness of the cost of credit to the user; and (2) that the bill's purpose is "to assure a full disclosure of such costs with a view to preventing the uninformed use of credit to the detriment of the national economy."

Disclosure requirement. The bill would require any person engaged in the business of extending credit to furnish to each of his credit customers, prior to consummation of the transaction, a written statement setting forth "in accordance with rules and regulations prescribed by" the Board of Governors of the Federal Reserve System, detailed information explaining the transaction, including (1) "the finance charge expressed in terms of dollars and cents," and (2) "the percentage that the finance charge bears to the total amount to be financed expressed as a simple annual rate on the outstanding unpaid balance of the obligation."

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Coverage. As indicated above, the bill would apply to any person engaged in the business of extending credit; and "credit" is defined very broadly to include both loan and sale credit. It would also cover both real estate and consumer credit, and the discount or purchase of credit obligations.

However, the Board would be required to provide exemption for credit transactions between business firms, and credit transactions in States having laws requiring creditors to disclose information of the same kinds required to be disclosed by the bill. In addition, the Board would be expected to exempt transactions subject to Federal law under which the disclosure requirements of the bill were being achieved.

The bill defines "finance charges" to include "interest, fees, service charges, discounts, and such other charges incident to the extension of credit as the Board may by regulation prescribe."

Regulations. The Board would be given broad authority, in addition to the foregoing, to prescribe such regulations as it deemed necessary or proper to carry out the bill and to prevent evasions, including the making of classifications, differentiations, and exceptions.

Consultation with other agencies. In administering the bill, the Board would be required to request the views of other Federal agencies with regulatory authority over creditors, and such agencies would be required to comply with the Board's requests.

Penalties. Transactions in violation of the bill or the Board's rules and regulations would not be made unenforceable. However, a violating creditor would be subject to a civil penalty at the suit of the customer for $100, or an amount equal to twice the total finance charge on the transaction, whichever would be the greater, but in no event could the penalty exceed $2,000 on any credit transaction. In addition, willful violations would be subject to criminal penalties (misdemeanors). The penalty provisions, of course, would not be applicable against any Government agency.

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Chairman Martin

To: Board of Governors

Subject: Tobin testimony on "Truth in Lending" bill, S. 1740.

From: Jerome W. Shay

This morning James Tobin testified in behalf of the Council of Economic Advisers at the first session of hearings on S. 1740, the "truth in lending" bill before Senator Douglas' Production and Stabilization Subcommittee of the Senate Committee on Banking and Currency. His testimony was favorable to the bill.

At the outset of the hearing both Chairman Douglas and Senator Bennett made fairly long opening statements which, in effect, summarized the extended remarks that each has made previously on the floor of the Senate concerning the bill. These floor speeches were circulated among the members of the Board at the time they appeared in the Congressional Record. In short, Senator Douglas argued that "enactment of the bill would reduce the uninformed use of credit that contributes to economic instability, help borrowers choose more wisely among sources of credit, but in no way would regulate credit or the cost of credit." Senator Douglas also pointed out that all the Government agencies who had been asked to report on the bill favored its purposes and objectives although some of the reporting agencies made suggestions as to various aspects of the bill.

Senator Bennett's opening remarks referred to the Board's report on S. 1740 as supporting his view that the bill would not have a stabilizing effect on the economy. His remarks also included his view that the only way the bill could work would be if the Government imposed a broad schedule of cash retail selling prices so as to prevent compensating price increases which merchants would in his judgment make in order to permit quotations of lower credit costs.

It is particularly significant as the following quotations from Mr. Tobin's formal statement indicate that he believes the bill would have a counter-cyclical effect.

> "I feel that the contribution of this bill to economic stabilization lies in making credit buying more timely, not in whatever small effect it may have on the average level of consumer credit. I do not think that the overall level of consumer credit in the economy is at issue here. Overall household debt, although not an excessive burden on normal incomes, may be troublesome when incomes decline in recession. If debt has been over-expanded in a boom, the continuing necessity to make payments in recession may depress consumer demand just when the economy needs stimulus. From the point of view of counter-cyclical policy, it would be desirable to restrain excessive expansion of credit purchases in booms and to encourage the use of credit in recessions.

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"Actually, the cost of credit is a natural counter-cyclical influence on the timing of credit purchases and repayments, and the purpose of the bill is to increase the efficacy of this mechanism. The cost of credit normally rises in periods of boom and inflation and falls in periods of recession. This natural cycle in credit charges, reinforced by monetary and credit policy, is a stabilizing force in the economy. High credit costs in boom periods restrain credit purchases; low costs in periods of slack encourage credit buying. These variations in credit costs help to dampen the business cycle.

"However, the stabilizing effect of changes in credit costs depends on awareness by consumers that the changes have occurred. If buyers are ignorant of the true costs of credit, they are less subject to influence by cost changes. By increasing consumer awareness, this bill will help to make the cyclical fluctuation of credit costs a more stabilizing influence on the economy. In times of boom, rises in finance charges will be more evident to borrowers, while in periods of relative recession, borrowers will be made aware of the more favorable terms on which credit is then available.

"Increased information available to prospective credit buyers will also help to make monetary policy more effective. The Federal Reserve and Treasury try to moderate economic fluctuations through changes in credit conditions, easing credit in recessions and tightening money in booms. The degree to which consumer demand reacts to changes in credit costs and terms is difficult to estimate. But if consumers are better informed about credit costs, they will surely be more sensitive to variations in credit conditions, and consumer demand will be more responsive to basic monetary policy."

Mr. Tobin's concluding remarks in his formal statement before the committee were as follows:

"Credit purchases make a highly significant contribution to the welfare of American consumers and to the functioning of our economy. This bill, S. 1740, can only increase this contribution. Consumers will buy and borrow with better information concerning the choices available to them. No seller of good merchandise need fear to provide potential customers with accurate information. Consumer loans and the goods whose purchase they finance are generally good merchandise. Consumers will use credit with more intelligence and discrimination under the provisions of this bill; but I do not think they will use it less."

Points of further significance so far as the Board is concerned arose during questioning with Senator Douglas and Senator Bennett. In reply to questions by Senator Douglas Mr. Tobin's answers seemed to indicate that the cost of banks' loans to businesses including, for example, sales finance

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companies, were almost always quoted and handled on a simple annual rate basis. During questioning by Senator Bennett Mr. Tobin agreed that some business loans were on a discount basis. These colloquys would suggest that the practice of banks in this connection would be a matter which the committee will want to pursue further.

Senator Bennett asked Mr. Tobin if the Council had any statistics that would relate changes in finance charges on consumer credit to changes in the cost of money generally over the last three business cycles. Mr. Tobin replied in effect that they did not have any statistics although the inference of his remarks and also those of Senator Bennett was that this would be a matter on which the Federal Reserve would have information. In this connection Senator Bennett referred to the Board's report on S. 1740 as supporting his view that interest rates on consumer credit do not vary cyclically.

In reply to a question by Senator Bush Mr. Tobin rejected the enactment of a bill giving the Board standby authority over consumer credit as an alternative to enactment of S. 1740. Mr. Tobin indicated that consumer credit controls of the Regulation W type would be much more rigorous. He also seemed to be of the view that consumer credit regulation did not lend itself to being turned on or off on a cyclical basis because of the administrative problems that would be involved and that it should be saved for emergency situations.

In reply to a further question by Senator Bush as to the ability or competence of the Federal Reserve to administer S. 1740, Mr. Tobin replied that "perhaps the Federal Reserve is not the most appropriate agency." It "does not necessarily have to be the Federal Reserve rather than possibly the Federal Trade Commission or even some other agency."

As was true during the hearings on legislation of this kind last year much questioning resolved around the existence or adequacy of state laws dealing with the subject. This, of course, is regarded as relevant by those who argue against enactment of a measure such as S. 1740. On the other hand, the proponents of the legislation argue that the bill does not necessarily oust itself from this field of legislation since in its present form the bill exempts credit in those states which have laws requiring disclosure of the same type of information in credit transactions as that required by S. 1740. The question of the laws of the various states may well be a matter in which the committee will seek further information.

While there was fairly good attendance by members of the subcommittee, most of the questioning was by Chairman Douglas and Senators Bennett and Bush. Press coverage was fair.

cc: Each Board member, Mr. Thomas, Mr. Knipe, Mr. Molony, Mr. Fauver, Mr. Young, Mr. Sherman, Mr. Koch, Mr. Williams, Mr. Hackley, Mr. Solomon and Mr. Masters.

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7/18

Mr Martin

Mr. Masters wanted to point out that the underscored portion on the second page of his memo is the only significant point you need keep in mind with respect to the probability of the Committee's asking you again this year a question re applicability to national banks of State laws affecting disclosure practices.

mnm

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

# Office Correspondence

Date July 17, 1961.

To Mr. Shay

Subject:

From R. C. Masters

When Chairman Martin testified on S-2755, the Consumer Credit Labeling Bill, before the Subcommittee on Production and Stabilization of the Senate Banking and Currency Committee on April 5, 1960, he was questioned concerning the scope of inquiry of Federal Reserve Bank examiners into practices of State member banks concerned with their consumer installment lending operations. Specifically, the questions dealt with whether the credit terms were being improperly concealed and whether borrowers were acquainted with the true rate of interest applicable to such borrowings.

In further elaboration of the Chairman's responses, the following statement was prepared and submitted to the Subcommittee for inclusion in the record of the hearings:

> "Federal Reserve examiners are interested in the soundness and solvency of the State member banks they examine, and the compliance by those banks particularly with applicable provisions of Federal banking laws. They review loans for the purpose of determining their authenticity, soundness, and conformance with law, but would have no means of ascertaining the extent of disclosure of terms to borrowers except as the notes or loan agreements in the bank's records revealed those terms. If a State law requires disclosure of credit terms by a bank, investigation of loans subject to the law will normally be made by the State examiners who customarily examine State member banks in cooperation with the Federal Reserve examiners.
>
> "In the circumstances, it would be unusual for Federal Reserve examiners to have occasion to report on whether not borrowers are notified of credit terms. An exhaustive review of examination reports has not been made since it could not be expected to add appreciably to the information outlined above."

This response factually states the situation concerning the activities of Federal Reserve Bank examiners with respect to this phase of the consumer lending operations of banks. There might also be added to the statement the fact that bank examiners would have no way of knowing to what extent, if any, borrowers were advised orally by lending officers of the true percentage rate of interest as a conversion of the dollar charges added to the face of a note. The only insight examiners could gain with respect to such a matter would be through discussion with bank management of their general disclosure practices in discussions with prospective borrowers.

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Chairman Martin was also questioned during the 1960 Hearings as to the applicability to national banks of State laws affecting disclosure practices relative to service charges, interest rates, etc. As similar questions may again be raised on July 19, when the Chairman appears to testify on the new bill (S-1740) the following, which was submitted to the record during the 1960 Hearings, may be helpful on this point:

"It is understood that the Comptroller of the Currency, who examines and supervises national banks, has taken the position that national banks must comply with the substantive provisions of State laws dealing with the forms used in connection with the sale of motor vehicles and similar transactions, the interest or finance charges or other charges that may be made, insurance overcharges, rebates, return of contracts, repossession notes, and so on. It is the view of the Comptroller that national banks may not be compelled to secure State licenses to engage in business that they are authorized to engage in by Federal law; but the Comptroller's Office has not objected to national banks voluntarily securing licenses under State laws and paying the prescribed license fee therefor. However, the Comptroller takes the position that State laws may not validly provide that submission to an examination is a prerequisite to a national bank's engaging in such businesses, and that a State may not interfere with the legitimate business of national banks if they do not submit to examination by State authorities with respect to these matters. This position is based on section 5240 of the Revised Statutes (12 U.S.C. 484), which provides that 'no bank shall be subject to any visitatorial powers other than such as are authorized by law, or vested in the courts of justice or such as shall be or shall have been exercised or directed by Congress, or by either House thereof or by any committee of Congress or of either House duly authorized.'"

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July 18, 1961.

To: Chairman Martin

Subject: re hearings on S. 1740, truth in lending bill.

From: Jerry Shay

I am not sure but Senator Douglas might be critical of us for not being more helpful in determining what the various state laws provide with respect to disclosure of finance charges. You will recall that last year we did check some information on this subject published by commercial sources. This year it was understood that the committee would not ask us for further work in this field unless they failed to obtain assistance earlier, and we heard nothing further from the committee. There is attached a statement which Howard Hackley has prepared explaining the complicated nature of explorations into the state laws.

Also attached is a memorandum to me from Mr. Masters reviewing two other matters which are likely to come up at the hearing on S. 1740, i.e., the scope of the inquiry of Federal Reserve examiners into the practices of State member banks concerning their consumer installment lending operations, and the applicability to national banks of state laws affecting disclosure practices relative to finance charges.

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It would be possible, of course, for the Board's Legal Division to undertake a compilation of State laws relating to disclosure of finance charges. However, this is a subject completely foreign to the scope of the Board's present functions and our lawyers have no special knowledge or experience in this field. They do not, for example, have the familiarity with the subject that presumably would be possessed by lawyers for nationwide finance companies. Consequently, a careful compilation of State laws on this subject, if undertaken by the Board's attorneys, would undoubtedly require considerable time, perhaps several months. Such a project would, of course, substantially impair the ability of the Board's legal staff, which is relatively small, to discharge promptly its functions in connection with the Board's present statutory responsibilities.

7-18-61

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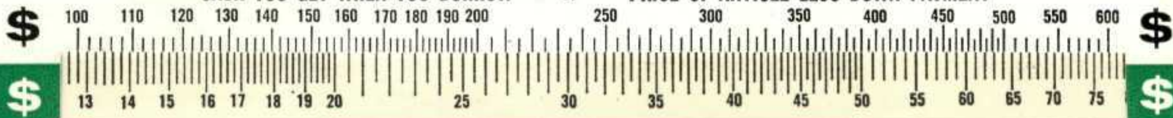


# Quick CREDIT COST Computer

It Will Pay You To Save First— And Buy Later!

Before you buy on time, know how much you are paying. Some time payment plans cost more than others.

## Bowery Savings Bank

42nd STREET . . Opposite Grand Central Terminal
BOWERY . . . . At Grand Street
FIFTH AVENUE. . At 34th Street
34th & 33rd STS. West of 7th Avenue
145th STREET. . At St. Nicholas Ave.

EXAMPLE and INSTRUCTIONS: If you are asked to pay $18.20 a month for the next 12 months and the price of the article you buy less down payment is $200.00, move slide until $18.20 lines up with $200.00 and you will note that in the 12 Months To Pay row 17 percent will appear in the window under the line as your approximate True Interest Rate.

WHEN BLACK APPEARS IN WINDOW INTEREST RATE IS ABOVE 40 PERCENT.

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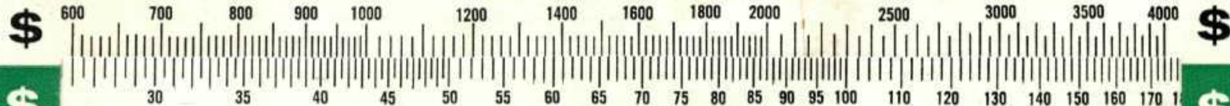
CASH YOU GET WHEN YOU BORROW or PRICE OF ARTICLE LESS DOWN PAYMENT




MONTHLY PAYMENT $

$ MONTHLY PAYMENT

# It Will Pay You To Save First— And Buy Later!

MONTHS TO PAY

TOTAL COSTS* SHOWN AS TRUE INTEREST RATE

*including interest, insurance and other charges

If you save up and buy for cash, instead of buying on time, your income will go a lot further. You'll not only save the finance charges, but your savings will also earn generous interest-dividends.

Bowery Savings Bank

NEW YORK, NEW YORK

Member Federal Deposit Insurance Corporation

INSTRUCTIONS: 1. Pull slide until "Monthly Payment" figure lines up with "Cash You Get When You Borrow or Price of Article Less Down Payment."
2. Opposite your "Months To Pay" row is approximately the "True Interest Rate" you are asked to pay.
WHEN BLACK APPEARS IN WINDOW INTEREST RATE IS ABOVE 40 PERCENT.

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BOARD OF GOVERNORS
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FEDERAL RESERVE SYSTEM

# Office Correspondence

Date July 18, 1961.

To Chairman Martin

Subject:

From Jerome W. Shay

Attached is a so-called "quick credit cost computer" which has been prepared by the Savings Bank Association of the State of New York and distributed by the Bowery Savings Bank. Recently one of these computers was given to me by Jonathan Lindley, the Senate Banking and Currency staff man working for Senator Douglas on S. 1740, the truth in lending bill.

Mr. Lindley attached a note saying that the computer might be of interest to you. This was an obvious reference to Senator Douglas' often repeated observation following the hearing last year that "even the Chairman of the Federal Reserve Board testified that he found the computation of installment credit costs to be confusing." I should think it almost a certainty that Senator Douglas will question you in some way concerning this "quick credit cost computer."

The main witness at this morning's session at the hearings on S. 1740 was Morris D. Crawford, Jr., Executive Vice President of the Bowery Savings Bank and Chairman of the Committee on Public Information of the Savings Bank Association of New York and also Chairman of the Committee on Federal Legislation of the National Association of Mutual Savings Banks. Almost the entire morning was taken up discussing and demonstrating the "quick credit cost computer." Mr. Crawford made it very clear that the computer was not designed for use by sellers or vendors in complying with the disclosure requirements of S. 1740. He explained that the purpose of the computer was to serve as a guide or yardstick for use by customers in order to determine the approximate cost of credit from various sources. Pursuant to questioning by Senator Bennett, it was made abundantly clear that the computer had obvious limitations, for example, it does not cover installment contracts with irregular payments or terms, nor does it cover the very frequent installment sale "add-on" transaction.

Mr. Crawford and his associates at the hearing explained that the computer was based on a formula used by the Federal Reserve System for computing rates on installment loans in its Consumer Credit Study of 1957. They explained further that this formula was the one known as the "constant ratio formula."

As I have indicated, Senator Douglas is almost sure to ask you about the "quick credit cost computer" and ask you to use it on certain hypothetical transactions.

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This morning's witnesses seemed fairly certain that rate books could be prepared for use by lenders and vendors in determining simple annual interest rates for the purpose of S. 1740 and that these rate books would cover almost all of the various types of transactions, say 95 per cent. Their feeling was that in the neighborhood of 5 per cent all installment contracts involved such irregularities or unusual situations as to make the use of a rate book impracticable for those cases.

In addition to questions with respect to the "quick credit cost computer" you might be asked to calculate the simple annual interest rate on a given installment credit transaction using no more than "a pencil, paper and a calendar." James Tobin was asked to do this. The object seems to be to prove that different people arrive at different answers or find the process so complicated as to make errors.

cc: Mr. Ralph Young
Mona Dingle

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CHAIRMAN MARTIN

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July 19, 1961.

Board of Governors | Subject: "Truth in lending" bill

Mr. Hackley

For the Board's information, there is attached a copy of a letter received this morning from the Bureau of the Budget enclosing a copy of a letter dated July 12, 1961, addressed by the Bureau of the Budget to the Chairman of the Federal Trade Commission with respect to the proposed report of that Commission on S. 1740, the so-called "truth in lending" bill. It is of interest that the Budget Bureau's letter to the Trade Commission expresses the view that it would be appropriate to assign administrative responsibility to the Federal Trade Commission.

Attachment

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EXECUTIVE OFFICE OF THE PRESIDENT
BUREAU OF THE BUDGET
WASHINGTON 25, D.C.

July 18, 1961.

Honorable William McC. Martin, Jr.
Chairman, Board of Governors of the
Federal Reserve System
Washington 25, D. C.

Attention: Howard H. Hackley
1046 Federal Reserve Building

Dear Mr. Chairman:

For your information, a copy is enclosed of a letter of advice sent by the Bureau of the Budget to the Chairman of the Federal Trade Commission regarding the Commission's proposed report on S. 1740, a bill "To assist in the promotion of economic stabilization by requiring the disclosure of finance charges in connection with extensions of credit."

Sincerely yours,

(Signed) Phillip S. Hughes

Phillip S. Hughes
Assistant Director for
Legislative Reference

Enclosure

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July 12, 1961

Honorable Paul R. Dixon
Chairman, Federal Trade Commission
Washington 25, D. C.

Attention: Joseph W. Shea
426 Federal Trade Building

Dear Mr. Chairman:

This will acknowledge receipt of your letter of June 27, 1961, transmitting copies of the report that the Federal Trade Commission proposes to present with respect to S. 1740, a bill "To assist in the promotion of economic stabilization by requiring the disclosure of finance charges in connection with extensions of credit."

The Board of Governors of the Federal Reserve System, in the report which it has already submitted to the Committee, concludes that it would be inappropriate for the Board to administer a statute dealing essentially with trade practices. In the circumstances, it would appear appropriate to assign administrative responsibility for the proposed program to the Federal Trade Commission. We understand that the Commission probably would be willing to administer such a program if the bill were suitably amended so as to enable the Commission to administer it efficiently in conjunction with other comparable responsibilities.

In reply, you are advised that there is no objection to the presentation of your proposed report and that enactment of legislation requiring adequate disclosure of finance charges would be consistent with the Administration's objectives. It would be appreciated if you would submit a copy of this advice to the Committee.

Sincerely yours,

(Signed) PHILLIP S. HUGHES

Assistant Director for
Legislative Reference

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**Article Title:** Martin Voices Reservation on 'Truth in Lending' Bill

**Journal Title:** American Banker

**Date:** July 20, 1961

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Miss Muehlhaus

August 2, 1961

Mr. W. Maxey Jarman
Chairman
Genesco
Nashville 3, Tennessee.

Dear Mr. Jarman:

Thank you for your letter of July 28, commenting on my statement to the Senate Banking Committee on S. 1740, a bill to require disclosure of finance charges in connection with extensions of credit.

You will, of course, be able to see my full testimony before the Committee when its Record of Hearings is printed but, in view of your comments on the practical problems involved and on State laws, you may have some interest meanwhile in these pertinent passages from the transcript after my statement had been read:

> Senator Douglas: Mr. Martin, you say you support the objectives of the bill. Do you favor the enactment of this bill apart from the question of its administration?
>
> Mr. Martin: I do not know whether I do or not, Senator. There have been some questions raised in my mind. It depends on how it is administered, and I would assume --
>
> Senator Douglas: Waiving the question of administration.
>
> Mr. Martin: Waiving the question of administration, I do.
>
> * * * *
>
> Senator Proxmire: ... Senator Bush has asked... about the possibility of requiring only the finance charges and not the simple rate. In other words, the charges would be disclosed in advance, not the rate. Many States do not

FOR FILES
M. Muehlhaus

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require this...Is it your feeling that if you required only the finance charges in this kind of bill that it would be meaningful?

Mr. Martin: Well, I think that would have to be tested a bit too. I believe the administration of this type of thing is a very difficult thing for the agency administering it as a trade practice to determine -- what is the value to the customer and what he will use. If the use of the simple interest is not going to be really helpful to him and just determining what the finance charge is as against what the cost is would be helpful, that is something the administering agency would want to study and work out. I have a little bit of a query in my mind with respect to specifying in a bill of this type exactly what information should be supplied, because I think it requires a good bit of experience and a good bit of testing.

Senator Proxmire: Certainly if it can be done, the simple annual interest rate would be more meaningful?

Mr. Martin: I would think so. But I also realize there are difficulties in that.

* * *

Senator Bennett: Since this is a trade practice, would you not think that this is a problem that might appropriately be handled at the State level rather than requiring uniform Federal law?

Mr. Martin: I suggested that that ought to be investigated by the committee carefully a year ago, when I was up (before the committee)....

Senator Bush: Well, I take it that you still feel as you did a year ago that we should thoroughly explore the State activity in this field. Can I assume from what you said that you would lean toward the view that this is a field in which the States should continue to have jurisdiction exclusive of Federal jurisdiction?

Mr. Martin: I would want to be very certain the States are not able to handle it before I would want to go to Federal legislation.

* * * *

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Perhaps these passages will give you a fuller understanding of my position regarding the pending proposal.

I do not however see how, in good conscience, the Board or I could do otherwise than, as I said in the statement you read, "look with favor on the general principle of the bill of requiring disclosure of finance charges."

Sincerely yours,

(SIGNED) WM. McC. MARTIN, JR.

Wm. McC. Martin, Jr.

CM:nk
cc: Miss Muehlhaus

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copy

GENESCO
Nashville 3, Tennessee

W. Maxey Jarman
Chairman of the Corporation

28 July 1961

Mr. William McC. Martin, Jr.
Chairman, Board of Governors
Federal Reserve System
Washington, D. C.

Dear Mr. Martin:

May I comment on the copy of the statement that I've just received that you made to the Senate Committee on the question of Bill S. 1740.

I could certainly agree that the Federal Reserve System should not be charged with enforcing such a bill, but I was sorry to see that you were in favor of the bill otherwise. Would you also recommend that each bank, when they loan money to a business, figure out exactly what the interest charges are on the unpaid balance? Banks have various ways of figuring this, as you of course know, and it's not always the rate that it seems to be.

Every state has laws governing interest charges and to add a Federal bill with all of its complications, extra expense to the government, extra expense to every person in business, seems to be very unnecessary. Apparently, Senator Douglas considers the American people a bunch of nincompoops and at the same time that he considers American business is out to gouge the public. We have a wonderful competitive system in this country if the government does not destroy it. That competitive system is a far better regulator than any Senate bill.

Sincerely.

(Signed) W. Maxey Jarman
Chairman of the corporation.

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A. WILLIS ROBERTSON, VA., CHAIRMAN
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JOHN G. TOWER, TEX.
MATTHEW HALE, CHIEF OF STAFF

WM

United States Senate

COMMITTEE ON BANKING AND CURRENCY

August 1, 1961

Hon. William McC. Martin, Jr.
Chairman, Board of Governors
of the Federal Reserve System
Washington 25, D. C.

Dear Mr. Chairman:

During the recent hearings on S. 1740, several questions arose in regard to various aspects of the Truth in Lending Bill, which the Federal Reserve might be competent to answer.

On Monday, July 17, during the questions of one of the witnesses there was some disagreement as to what the total per annum dollar amount of interest payments had been in the last few years. It would be very helpful to the Committee if your research staff would submit for the record on S. 1740 estimates on the total dollar amounts of interest payments on the consumer debt for the last few years. It would also be helpful if the same figures could be supplied for residential mortgage debt and personal debt in total.

On Wednesday, July 26, another question arose which the Federal Reserve might be able to comment on. The text of the transcript reads as follows:

> "Now, there is one other point that I would like to clear up and that was the statement of Dr. Johnson, that 73 percent of the cases that he examined could not be subject to quantitative handling and, therefore, had to be rejected. I am going to ask Mr. Lindley to take the testimony of Dr. Johnson, put it in a letter to the Federal Reserve System, a copy going to Senator Bennett, and ask the Federal Reserve Board and the experts who testified, the experts who handled this consumer finance study, to reply whether this statement of Dr. Johnson's is correct, and make such comment as they wish."

p. 9; #1

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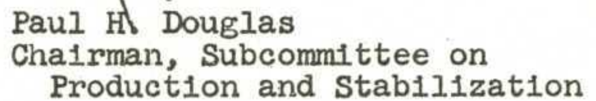
I am enclosing a copy of the statement by Robert W. Johnson, which might be helpful to your staff in researching this question.

Thank you for your courtesy.

Faithfully,



Paul H. Douglas
Chairman, Subcommittee on
Production and Stabilization

PHD:jlb
Enclosure
cc: Senator Bennett

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STATEMENT OF ROBERT W. JOHNSON, PROFESSOR OF FINANCIAL ADMINISTRATION, GRADUATE SCHOOL OF BUSINESS ADMINISTRATION, MICHIGAN STATE UNIVERSITY, BEFORE THE SUBCOMMITTEE ON PRODUCTION AND STABILIZATION OF THE COMMITTEE ON BANKING AND CURRENCY, JULY 18, 1961.

The proposed bill, S. 1740, or the "Truth in Lending Act" requires "the disclosure of finance charges in connection with extensions of credit." Most of the problems associated with the bill center on the meaning of "disclosure", and, parenthetically, the meaning of "truth." We should recognize that at the present time most finance charges are disclosed to consumers. Over the past half century there has developed in association with each segment of the credit market a particular method of stating the finance charge. It is true that sometimes the finance charge is buried in the selling price of the merchandise. This is exemplified by charge accounts in retail stores and by most credit card arrangements. In other instances, the finance charge is included in the monthly payments, and consumers must subtract the balance of the loan received or the unpaid balance on goods financed to determine the dollar finance charge. However, in the great bulk of cases, the credit charge is disclosed in some manner -- sometimes as a percentage per month or per year, sometimes as a dollar amount. Credit unions, consumer finance companies, banks with revolving check-credit plans, and retailers offering revolving-credit accounts state their finance charges as monthly percentages. In part this method developed through legal decree; in part it is the method best suited to the nature of the business. Mortgage lenders present the major portion of their finance charges as annual percentages and a minor portion, in form of "closing costs," as dollar amounts. Statement of the finance charge as a dollar amount is the typical practice of commercial banks and sales finance companies in financing instalment sales. Indeed, disclosure of the finance charge in this manner is a legal requirement in a number of states and a fair trade practice of the FTC for automobile financing.

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The crux of the matter rests with the manner of disclosure. "Truth" is defined by implication as presentation of "a simple annual rate." Since this feature represents a basic change in present practices of disclosure, the remainder of my analysis will be concerned with the impact of this proposal.

There appear to be two main reasons advanced for the presentation of finance charges as annual rates. The first is stated in the "Declaration of Purpose" of the bill; namely, that "economic stabilization is threatened when credit is used excessively." The second purpose was implicit in much of the testimony last year on S. 2755. This is the argument that statement of charges as annual rates will enable consumers to shop more effectively for credit. Let us examine each of these arguments in turn.

## Promotion of Economic Stabilization

It is difficult to see how statement of finance charges as annual rates will promote economic stabilization. First of all, it has not been established that there is, or has been, an excessive use of consumer credit as suggested in Section 2 of S. 1740. Second, if there is an excessive use of credit, it has not been shown that statement of finance charges as annual rates will curb the presumed excessive use. The demand for credit is a derived demand, a demand secondary to the demand for new cars, washing machines, and other consumer durables. Will the young housewife forego the instalment purchase of a washing machine when the finance charge is stated as an annual rate? I do not know, but I suspect not.

It would appear that the most reasonable argument that can be advanced for the interest-rate form of statement as a means of promoting economic stabilization is along the following lines. In times of boom, finance rates

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would be high, and consumers would be discouraged from use of credit. However, during periods of recession, finance rates would decline, so that consumers would be encouraged to purchase goods on credit and stimulate recovery. This argument suffers from a number of defects. In the first place, it overlooks the fact that the consumer is usually buying a product or service with his credit. A large reduction in the cost of credit will cause only a small percentage reduction in the time price of the product purchased. Second, it is very unlikely that consumer finance rates would be sufficiently flexible to affect consumers' use of credit. Interest rates paid by credit institutions are only a small portion of their total costs of providing the credit service. For example, during 1958 interest costs of sales finance companies in Indiana absorbed only one-third of gross income. Moreover, because these companies obtain a fairly large proportion of their funds from long-term borrowings, this portion of their interest costs is not immediately responsive to changes in money rates. At the end of 1960, the four largest independent sales finance companies obtained about half of their borrowed funds under long-term commitments.

What does all this add up to? Let us assume that a consumer is considering the time purchase of a $100 radio, but is waiting until finance rates decline. Let us say that at the peak of the boom, when short-term money costs 6 percent, his finance charge would be $8 on a 12-month contract, or an effective annual rate of about 14.8 percent. In the recession that follows money rates are cut in half; they fall to 3 percent. Sales finance companies are now able to obtain short-term loans at half their earlier cost, and they pass the full reduction along to consumers. If we assume the sources and costs of funds described earlier, it can be shown that the total finance charge to the

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consumer will decline to $7.33 from $8, and the annual rate will decline to 13.5 percent from 14.8 percent. The overall effect of the reduction in the finance charge will be to cut the time price of the product by 6/10ths of 1 percent. Thus, even a dramatic change in money rates will produce a relatively minor change in consumer finance rates and a negligible change in the time price of a product.

The inflexibility of finance charges is supported by historical data. The Federal Reserve Board's study on consumer instalment credit showed that over the 10-year period from 1946 through 1956 finance charges on a popular-priced passenger car varied by no more than 10 percent.[1] Over the same period average bank rates on business loans doubled. Logic and historical evidence suggests that we can not expect statement of consumer finance charges as annual rates to promote economic stabilization.

Permit Consumers to Compare Finance Rates

The assertion that statement of finance charges as anual rates would permit consumers to shop more effectively for credit has a much greater appeal. From our economic training we recognize that markets function better when both buyers and sellers have full information. It is most reasonable to suggest that all consumer finance charges be converted to a single form, such as a simple annual rate of interest on the monthly unpaid balance.

In spite of the industry's arguments to the contrary, it seems likely that consumers will understand enough about annual percentage rates to recognize that 12 percent is higher than 10 percent. The real problem is whether or not properly comparable rates can be presented to the consumer in writing prior to the consummation of each credit transaction. This will not be

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[1]Consumer Instalment Credit: Growth and Import (Washington, D. C.: Federal Reserve System, 1957), Part 1, V. L, p. 59

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possible in a large proportion of consumer credit transactions, either because the finance charge can be concealed or because the annual rate can not be calculated.

East of concealing finance charges. On instalment sales transactions, retailers are free to set the cash price of their products and their finance charges, subject to limits imposed by various state laws. Thus the size of each of the components in the total time price is a matter of discretion. Dealers in automobiles and other consumer durables and those engaged in home repair and modernization could easily drive the finance charge into the cash price of the product or service. As a result they could quote very low financing rates to attract customers from direct lenders, such as commercial banks, credit unions, and consumer finance companies.

To illustrate, assume that the cash price on a used car is $800 (Table 1). With a downpayment of $200, the principal amount to be financed would be $600. On a two-year contract with an add-on finance charge of 9 percent per year, the dollar finance charge would be $108, and the time balance $708. The annual rate of charge is about 17.5 percent. If required to state his charges as annual rates, the dealer could raise his cash price to $887, an increase of only 11 percent. A downpayment of $200 would leave a principal amount to be financed of $687. The addition of a finance charge of only $21 would bring the time balance to $708, as before. But now the dealer is in a position to advertise low financing rates of less than 3 percent per annum. He can urge consumers to finance with him rather than through their credit union at 12 percent. Moreover, the consumer would have every reason to believe that he could rely on the truth of the rate disclosed in this manner, for it would be in accordance with the "Truth in Lending Act" administered by the Federal Reserve Board.

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Table 1 Recalculation of Terms on Instalment Sale to Lower Effective Annual Rate of Finance Charge

| | 24-month Contract | |
|---|---|---|
| | Before Adjustment | After Adjustment |
| Cash price | $800 | $887 |
| Less: Downpayment | 200 | 200 |
| Principal amount financed | 600 | 687 |
| Finance charge | 108 | 21 |
| Time balance | $708 | $708 |
| Monthly payment | $29.50 | $29.50 |
| Effective annual rate* | 17.3% | 2.9% |

*The rate is calculated using the constant ratio method of converting the dollar charge to an annual rate.

Source: Robert W. Johnson, Methods of Stating Consumer Finance Charges (New York: Graduate School of Business, Columbia University, 1961), p. 96.

This burial of finance charges in the price of the product financed has been common practice for some years in the case of FHA-insured and VA-guaranteed loans. When the market rate on mortgage loans is above the permitted rate, the builder often absorbs a portion of the finance charge and then passes it on to the buyer in the form of a higher price on the house. On these loans the charge is stated as an annual rate as required in S. 1740 -- but in these cases there is no truth in this form of rate statement.

Impossibility of calculating annual rates. On many types of consumer credit it is not feasible to calculate annual rates so that they may be stated prior to the consummation of the credit transaction. In this category we should list revolving credit, check credit, and possibly instalment credit granted by mail order concerns.

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Let us concentrate on the problems associated with revolving credit offered by many retailers. Assume that I have agreed to pay $20 a month on a revolving-credit account at a department store in Lansing, Michigan. Suppose that on July 15, I purchased a $20 item. If this is all that I buy during July, the store will add 30 cents to the unpaid balance at the end of the month. Should I pay the bill promptly on August 1, I will have paid 30 cents to use $20 credit for 15 days. This is an annual rate of 36 percent. But if after purchasing the first $20 item I wander off and make another purchase of $20, my annual finance rate will decline. If I make $20 payments promptly on August 1 and September 1, my annual finance rate will be about 27 percent. With each additional item I purchase my annual rate of charge declines closer and closer to 18 percent. If you wish further complications, let me point out that there is also a minimum monthly charge of 25 cents. The sales clerk can not know my unpaid balance at the moment she sells me a shirt for $5, nor can she know what additional purchases I will make after I leave her counter. She can not possibly tell me the annual rate of finance charge that I will pay on the purchase of that shirt prior to the consummation of the transaction.

Check-credit plans whereby consumers may borrow from commercial banks by signing special checks involve impossible complexities similar to those provided by revolving credit accounts. At present such concerns as Sears, Roebuck & Co. publish a table in their catalogues showing the exact amount of the dollar finance charge the customer will pay, depending upon the price of the item purchased on instalment. While the complexities surrounding conversion of these finance charges to annual rates may not be insurmountable in the case of mail-order companies, they may be so great as to interfere seriously with this method of serving consumers.

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Consequently, under the proposed legislation the consumer shopping for a refrigerator might find that the credit union or commercial bank would quote a financing rate close to 12 percent, the credit appliance store a rate of 3 percent, and the department store unable to quote any rate at all on its revolving credit plan. Is this full disclosure?

Difficulty of identifying the finance charge. There are numerous problems in defining the dollar finance charge. Look down the list of disbursements included under "closing costs" on a mortgage: bank fee, tax history, survey fee, attorney's fee, title insurance, credit report, and so on. Which of these are part of the finance charge and which are not? To reach a fair and truthful conclusion would require scrutiny of almost every transaction. Moreover, many of these fees have their counterparts in charges on consumer instalment credit. Uniform treatment of such fees may easily conflict with many state laws that now limit the finance charges on small loans and instalment sales transactions.

Difficulty of converting dollar charge to annual rate. Too much has probably been made of the diverse answers that can be obtained with the various formulas available to convert the dollar charge into an annual rate. Some one formula could be selected by the regulatory body and defined as the proper method of making the conversion.

However, use of a standard formula would force consumers to adjust their payments to the uniform mold required by the formula. Consider the school teacher who would like to buy a $265 refrigerator in May, pay $50 in June, $75 in September and October, and the balance of $83.15 in November. I have been teaching rate calculations in industry programs over the past five or six years, and I can assure you that none of my students can make this calculation.

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There are so many deviations possible on consumer credit contracts: the number of days to the first payment, the regularity of payments, the size of the last payment. Some indication of the variation one encounters in practice is suggested by the survey made by the Federal Reserve Board of new car buyers in 1954 and 1955. In calculating annual finance rates, we used the constant-ratio method of converting dollar charges to annual rates. Even with the use of an electronic computer and a large staff in the market survey organization, we found it necessary to exclude 73 percent of 1954 contracts and 43 percent of 1955 contracts because of the difficulty or impossibility of computing the annual finance rate.

Let me summarize in concrete terms the results of the ease of concealing the finance charge and the frequent impossibility of converting the charge to an annual rate. At the end of 1960, there was outstanding about $56 billion of consumer credit. Some $12.8 billion was in the form of noninstalment credit: single-payment loans, charge accounts, and service credit (credit extended by utilities, doctors, credit card companies, and so on). In most of these transactions, the finance charge is already buried in the price of the product or service, so that it is not possible to determine the annual rate of charge.

This leaves about $43.3 billion of instalment credit. It would be possible to bury some portion of the dollar finance charge in the price of the product or service on roughly $26 billion, or 60 percent of this amount. These outstandings include revolving credit and check-credit, forms of instalment credit that would actually be immune from rate-statement legislation. Reliable estimates are not available on the amount of credit outstanding under these plans. This leaves only $17.3 billion as a <u>maximum</u> on which consumers

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can rely for a truthful presentation of annual rates. This amount represents about 40 percent of instalment credit and about 31 percent of total consumer credit. This falls far short of any goal of enabling consumers to shop effectively among all types of consumer credit and to compare rates charged by these alternative sources in order to use credit wisely.

## Summary

Whenever possible, consumers should be informed of the cost of their credit. There are too many cases in which consumers are not told of their dollar finance charge, but only told the number and amount of their monthly payments. The industry deserves to be criticized, but not castigated, for these practices. One of the benefits of the discussion of S. 1740 may be to encourage those credit institutions who do not now disclose finance charges to tell consumers the dollar cost, or the monthly or annual rate of charge for their credit service.

However, the argument that statement of charges as annual rates will promote economic stability rests upon assumptions that are unproved and, to put it mildly, tenuous. Far from enabling consumers to shop wisely for credit, legislation of this nature would benefit those dealers who would be able to conceal the finance charge. This deception of the consumer would be largely at the expense of direct lenders; commercial banks, credit unions, and consumer finance companies. It would indeed be unfortunate to facilitate deception of the consumer by providing the official sanction of a Federal act.

Criticism is easier than constructive suggestions. Let me display my biases by suggesting that in the long run the consumer will only be safeguarded in shopping for credit and all the other items that he buys through

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better education and greater economic progress. You can not take the consumer by the hand every time he goes shopping. Look at the types of people most frequently preyed upon by the unscrupulous minority that exists in this, as in any other, industry. My experience, and the evidence developed in last year's hearings indicates that these are the economically depressed, the racial and cultural minorities, the newcomers to this country. Sad to say, these people are least able to afford the losses they suffer at the hands of these predators. In part these people can be protected through vigorous enforcement of laws now on the books. In large measure, however, their protection must come from a significant improvement in their economic and educational status. Although progress on this score has been great over the past half century, as an educator, I am eager to see us move faster.

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Ch. Martin

AUG 10 1961

The Honorable Paul H. Douglas,
Chairman, Subcommittee on
Production and Stabilization,
Committee on Banking and Currency,
United States Senate,
Washington 25, D. C.

Dear Mr. Chairman:

The following information is being supplied in response to your letter of August 1, in which you ask for an estimate of total finance charges on consumer debt and refer to Mr. Robert Johnson's statement concerning the number of 1954 and 1955 contracts excluded from the computation of finance charges in our Survey of New Car Buyers.

The research staff of the Board of Governors estimates that the dollar amount of interest and finance charge payments on total debt of consumers amounted to about $15 billion in 1960. The estimate includes $6 billion of finance charges on short- and intermediate-term consumer instalment credit, $500 million on single-payment loans, $7.5 billion on mortgage debt, and $500 million on other consumer debt, including security loans and life insurance policy loans. These estimates have been prepared on the basis of very fragmentary information on finance charges on most types of loans. Available information on finance charges on consumer credit was summarized in the letter to you from Vice Chairman Balderston dated April 29, 1960.

It should be noted that the $6 billion for annual charges on consumer instalment debt should not be related directly to the outstanding balance to determine an estimated average rate on the amount borrowed. The outstanding amount reported for instalment contracts generally includes unearned finance charges for the remaining period to maturity.

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The available data do not permit distinguishing annual changes in finance rates. It may be inferred, however, that total annual charges on debts of consumers were somewhat smaller in 1958 and 1959 than in 1960, particularly on mortgage debt. Outstanding credit was smaller on the average in these years and rates on some types of credit were moderately lower.

Our records with respect to the computation of finance charges on loans covered in the Survey of New Car Buyers, conducted for the Board of Governors by National Analysts, Inc., in 1956, do not agree with Mr. Johnson's statement. Our data show that cases included in the tabulations of finance charges by the constant-ratio method accounted for 65 per cent of the lender report sample for 1954 and 73 per cent of that for 1955, or 70 per cent of the total sample for the two years combined.

Between 5 and 6 per cent of all contracts were excluded from these tabulations because they were single-payment loans and hence not relevant to the discussion of instalment credit terms. Finance charges on many of these could undoubtedly have been computed by conventional methods.

About 74 per cent of all instalment contracts were included in the computations. Of the 26 per cent excluded, 9 per cent were accounted for by cases in which lenders failed to supply information on finance charges. Another 7 per cent were accounted for by balloon notes--that is, contracts which provided for a final payment substantially in excess of earlier payments. These contracts were of some importance in 1954-55, but have been of little significance, at least for the major lenders, in recent years. The final 10 per cent was accounted for by a miscellaneous group of contracts for which no breakdown is available. It is known that they include, among other things, contracts in which finance charges were not incorporated in the total amount of credit specified and contracts of farmers and teachers in which payment patterns were made to conform to income patterns.

No attempt was made in these computations to identify, or make allowance for, cases in which the date of the first regular monthly payment may have been slightly more or slightly less than a

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month after the date of purchase. Any such contracts were included in the tabulations as loans with regular monthly payments. Neither was an attempt made to judge the difficulty of computing finance rates on individual contracts excluded from the tabulations for the various reasons noted above.

It should be emphasized that the data cited refer only to contracts on new automobiles purchased in 1954-55. Instalment contracts for purchasing other goods, or for purchasing new cars at other periods, may include larger or smaller proportions with variations in the frequency or size of payments.

We hope that this information answers your questions.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

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**By Messenger**

Attention Miss Burch

September 6, 1961.

The Honorable Frederick G. Dutton,
Special Assistant to the President,
The White House.

Dear Mr. Dutton:

In reply to a telephone call today from Miss Burch, I am glad to supply a copy of my statement on S. 1740, the "truth in lending bill," on July 19, 1961, before the Subcommittee on Production and Stabilization of the Senate Banking and Currency Committee. Also enclosed is a copy of the Board's report to the Committee on S. 1740. My full testimony on the bill will appear in the printed hearings which I understand will be available from the Banking and Currency Committee in about three weeks.

The Board's report, my testimony, and certain other information supplied by us in connection with the Subcommittee's consideration last year of S. 2755, predecessor to S. 1740, appear in the printed hearings on S. 2755. I am confident that you have copies of these hearings of last year.

Sincerely yours,

(SIGNED) WM. McC. MARTIN, Jr.

Wm. McC. Martin, Jr.

Enclosures

JWS:mnm

cc: Mr. Shay

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United States Senate

COMMITTEE ON BANKING AND CURRENCY

September 25, 1961

Hon. William McC. Martin
Chairman of the Board
Federal Reserve System
Washington 25, D. C.

Dear Mr. Martin:

I anticipate that further hearings will be held by the Production and Stabilization Subcommittee of the Senate Banking and Currency Committee on S. 1740, the Truth in Lending bill, early in the next session of Congress.

It has become apparent that the Subcommittee needs more complete information on the disclosure requirements of the various State laws governing the extension of consumer credit. Specific information is needed on the requirements of State laws in regard to the seven items of information which would be required to be disclosed by section 4 of S. 1740 on all consumer credit transactions.

It would be very helpful in our consideration of this bill if your agency would supply the Committee with this compilation. In view of the Federal Reserve's long-standing responsibility in the field of consumer credit, it would appear that your agency is the most knowledgeable in this area and best equipped to undertake this project.

I realize that it will take some time for your staff to collate this information, but I would hope that this digest of State laws could be forwarded to the Subcommittee on Production and Stabilization by the first of December, in order that the Committee staff would have time to study the material before the beginning of the next session of Congress.

If your staff should have any questions concerning the information requested, I would suggest that they confer directly with Mr. Jonathan Lindley, Staff Assistant on the Banking and Currency Committee.

Faithfully yours,

Paul H Douglas

Paul H. Douglas
Chairman
Subcommittee on Production and Stabilization

cc: Hon. A. Willis Robertson
Chairman, Committee on Banking and Currency

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

OFFICE OF THE VICE CHAIRMAN

September 28, 1961.

The Honorable Paul H. Douglas, Chairman,
Subcommittee on Production and Stabilization,
Committee on Banking and Currency,
United States Senate,
Washington 25, D. C.

Dear Mr. Chairman:

This is in response to your letter of September 25, 1961, requesting that we prepare for the use of your Subcommittee a compilation of State laws regarding the extension of consumer credit to the extent that they relate to the seven items of information that would be required to be disclosed by section 4 of S. 1740, the truth in lending bill.

We shall be glad to undertake the preparation of a compilation of the kind requested with the hope that it may be completed for submission to you by the first of December.

Sincerely yours,

(Signed) C. C. Balderston

C. Canby Balderston,
Vice Chairman.

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Mr. Chairman and Members of the Subcommittee:

You have asked that I appear before you today to comment on S. 1740, a bill to require disclosure of finance charges in connection with extensions of credit. I am glad to give you such assistance as I can in your consideration of this proposal.

Briefly, the bill would require a person engaged in the business of extending credit to furnish to each of his customers prior to the consummation of a credit transaction a written statement setting forth certain details concerning the credit in accordance with rules and regulations prescribed by the Board of Governors of the Federal Reserve System. These details would include (1) the finance charge expressed in dollars and cents and (2) the percentage that the finance charge bears to the total amount to be financed expressed as a simple annual rate on the outstanding unpaid balance of the obligation.

I should like to begin my statement by reaffirming the Board's general position as set forth in our report and statement on S. 2755, the similar bill considered by your Subcommittee last year, and repeated in our recent report on S. 1740. The Board is in full accord with the objective of requiring lenders and vendors to disclose fully their interest rates and finance charges to credit customers. The regulation of trade practices of vendors and lenders in stating finance charges, where necessary to provide credit customers with better information, is a commendable social and economic objective.

While we are in full sympathy with the "truth in lending" objective of the bill, we also believe, as we stated last year, that administration of such legislation would not constitute an appropriate

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activity for the Federal Reserve System. As you are aware, the major responsibility of the Federal Reserve is influencing the reserves of the banking system in the interests of economic stability and growth. The statute proposed in S. 1740, it seems to me, would be essentially a trade practices law not related to our primary responsibility, which is to regulate the availability and supply of credit in accordance with the over-all needs of the economy.

The bill is designed to protect the interests of borrowers or other retail credit customers on a continuing basis. It would do this by improving the quality of their information concerning the finance charges on credit contracts into which they may enter. As a result of the better information on financing charges, the bill would presumably facilitate customer choice as to type and source of available credit financing best suited to his pocketbook. In this way, the bill would work from the demand side to make the market for funds more competitive and make more efficient the allocation of resources generally.

The bill would not be administered as a contracyclical instrument, tightened in boom times and eased in times of slack. Rather it would be administered so as to give borrowers truthful information at all times--good and bad alike. Thus, regulation of the disclosure of finance charges under the bill would differ from the administration of general monetary policy. Its administration would also differ with respect to cyclical flexibility from the selective credit regulations, such as regulation of stock market credit which the Federal Reserve administers at present, and from regulations of consumer credit and real estate credit which the Federal Reserve has administered in the past.

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The question as to whether or not knowledge as to the actual cost of an article bought on credit tends to diminish cyclical fluctuations can be thought of in two parts. One part has to do with the price of the article itself; the other with the additional cost of buying it "on time."

Decisions as to whether or not to buy the item at all are made more intelligently, of course, when the true price is known. Since prices of goods and services fluctuate, potential buyers tend to be encouraged to purchase by prices they consider low and discouraged by those they consider high. Price changes on the items themselves, therefore, do have contracyclical influence and this influence is enhanced when potential buyers are quoted the total cost as well as the monthly payment.

If consumer finance charges actually did fluctuate with economic cycles, knowledge of the total cost of consumer credit itself would tend to have contracyclical effects. However, finance charges on consumer instalment credit, a major area that would be covered by the bill, have not shown much fluctuation in response to cyclical changes in the availability of credit during the postwar period. Also, it is hard to find evidence as to consumer responsiveness to the changes in charges that have occurred. Consumer instalment credit has been more responsive to changes in terms, such as maturities and downpayments, and in credit standards of lenders, than to changes in finance charges.

Finance charges on instalment loans, like charges on other types of credit, have risen from the lows reached in the World War II period. The rise has been gradual and, unlike money market interest

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rates, rates on consumer loans have not varied much in response to changes in the availability of and demand for credit over the course of postwar business cycles.

One factor of particular importance in connection with the prevailing level and relative invariability of credit charges on instalment loans is the presence of State laws setting maximum finance rates. Another factor is the relative importance of costs other than the cost of money per se in the consumer lending business. These costs, which include the cost of credit investigation, collection, and provision for losses, do not show much cyclical fluctuation.

This is not to say that consumer instalment credit is unresponsive to changes in monetary policy. Instalment lenders, like other lenders, are affected by changes in the supply of bank reserves. Commercial banks, which are most directly affected by changes in Federal Reserve policy, themselves hold about two-fifths of all outstanding consumer credit and also make loans in substantial volume to finance companies and retailers.

Changes in the availability of credit to instalment vendors and lenders tend to be reflected more in changes in the credit standards which lenders and vendors apply than in changes in their finance charges. When credit conditions tend to tighten, more restrictive credit standards tend to eliminate customers who are marginal risks.

On the other hand, when credit conditions become easier, instalment lenders and vendors are more willing to extend credit and to accept marginal risks. Moreover, consumer lenders and vendors tend to engage in more promotional activity when funds are readily available and to cut back on such activity when funds are hard to come by.

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In view of the technical characteristics of the consumer credit business, it seems unlikely that a fuller awareness by consumers of instalment finance charges in and of itself would make for increased cyclical variation in such charges and thereby result in much contra-cyclical effect on consumer borrowing. Whatever increased cyclical variation in rates and in borrower responsiveness to rate changes did result from the bill would, of course, be salutary. Cyclical flexibility in financing costs serves generally to discourage borrowing in boom periods and to encourage it in periods of slack.

Perhaps the most important effect of the bill in the instalment credit field would be in furthering the healthful functioning of the economy generally, through better allocation of resources. It would, indeed, be beneficial if a fuller consumer awareness of credit charges resulted in the avoidance of particularly burdensome indebtedness on the part of some consumers, or caused them to allocate their funds more economically.

While most of the discussion of this bill has been in terms of its role in requiring disclosure of terms on short-term consumer credit, the bill also would apparently apply to the mortgage credit area. Mortgage interest rates, like finance charges on consumer credit, have risen since the war, although they have fluctuated more in response to changes in credit availability.

Contract rates on first mortgages tend to be close to their effective rates. It is true that appreciable discounts are sometimes charged on mortgages insured or guaranteed by the Federal Government. This happens when administratively determined rates are below market rates. However, sizable discounts are seldom charged on mortgages of

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the conventional type. Moreover, charges other than the cost of money typically add little to the contract interest rates on mortgages.

There is unfortunately little information to be had about practices in disclosing financing charges to borrowers in second and third mortgage financing. If there is a problem requiring compulsory disclosure of contract costs in the mortgage field, it would seem to relate more to this area of financing than to first mortgages.

In conclusion, let me say that the Board of Governors looks with favor on the general principle of the bill of requiring disclosure of finance charges. At the same time, however, the Board believes that the administration of such a trade practice function would be essentially unrelated to the Board's present responsibilities. On behalf of the Board, therefore, I wish to reaffirm the position we took last year that administration of such legislation would not constitute an appropriate activity for the Federal Reserve.

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