CASH DISCOUNT ACT AND NATIONAL CONSUMER USURY COMMISSION

HEARING

BEFORE THE

SUBCOMMITTEE ON CONSUMER AFFAIRS

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

NINETY-SIXTH CONGRESS

SECOND SESSION

ON

H.R. 7340

TO AMEND THE TRUTH IN LENDING ACT TO ENCOURAGE CASH DISCOUNTS, AND FOR OTHER PURPOSES

AND

THE NATIONAL CONSUMER USURY COMMISSION

JULY 24, 1980

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THURSDAY, JULY 24, 1980

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON CONSUMER AFFAIRS,
Washington, D.C.

The subcommittee met at 10 a.m. in room 5302, Dirksen Senate Office Building, Senator George J. Mitchell, chairman of the subcommittee, presiding.

OPENING STATEMENT OF SENATOR MITCHELL

Senator MITCHELL. Good morning, ladies and gentlemen.

I want to begin this morning by thanking all of the witnesses for their cooperation in preparing their testimony and appearing here this morning on such short notice.

Today marks my first hearing as chairman of the Consumer Affairs Subcommittee. In that respect I am mindful of the prior activities of the subcommittee in seeking to protect the interests of consumers through such legislation as the Truth in Lending Act, the Equal Credit Opportunity Act, the Fair Credit Billing Act, and more recently reform of the Truth in Lending Act.

This morning we will hear testimony on H.R. 7340 which was passed in the House by a voice vote on June 3 of this year. In addition to our discussion of the unlimited cash discounts permitted by H.R. 7340, I have asked the witnesses for their views on the need for surcharges.

In these difficult economic times, we cannot overlook any proposal which might offer some relief to consumers. Cash discounts of up to 5 percent have been available to merchants since 1975, yet during that time retailers and others who accept credit cards have evidenced little interest in offering such discounts. I believe, therefore, that we should consider the potential savings to customers which may result from either cash discounts or surcharges.

Consideration of the subject of Federal regulation of cash discounts and surcharges leads to consideration of the broader question of whether the Federal Government should continue to extend its reach into areas of economic regulation previously left to the States.

Shortly after taking office and assuming the chairmanship of this subcommittee, I was approached by an official from my home State of Maine who raised the question of whether there should be additional Federal preemption of State consumer usury ceilings. She and many others share a deep concern over recent Congressional action affecting State consumer usury laws.

As we all know, during the past year, the Congress has preempted State consumer usury ceilings relating to housing and mobile home loans. The Congress has further preempted the States in this area by authorizing any lender to impose consumer loan rates up to 1 percent over the Federal Reserve Board discount rate regardless of State usury ceilings.

It appears likely that lenders and creditors will present further requests to the 97th Congress to preempt the remaining State consumer usury ceilings. There are many State banking regulators and officials, consumer organizations, members of Congress and individual citizens who believe that this would represent an unnecessary and unjustified usurpation of the right of each State to determine its own usury ceilings based upon local needs and conditions.

Most people say they want less Federal intervention in their lives, not more. While I'm not an expert in this area, I am persuaded that this is an important national issue which deserves to be objectively and thoroughly considered by the Congress before we move further to preempt State laws.

To aid the Congress in its deliberations, we will consider today the creation of a National Consumer Usury Commission. The Commission would be given a year to review this complex and controversial issue and report back to the President and the Congress on what need exists, if any, for further Federal preemption of State consumer usury laws.

The makeup of this Commission should be such as to encourage the careful dialogue that must precede deliberation and action, if any, by Congress in this area. I am sensitive to the need to keep the cost of any such commission to an absolute minimum and will therefore be requesting suggestions of the Board and the Federal Trade Commission on how we can most economically staff the Commission with their assistance.

Before proceeding to the first witness, I would like to place into the record a letter and statement that I received from the Honorable Frank Annunzio, chairman of the Subcommittee on Consumer Affairs of the Committee on Banking, Finance and Urban Affairs of the House of Representatives.

[Statement of Congressman Anunzio and copy of H.R. 7340 follow:]

STATEMENT OF FRANK ANNUNZIO, REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. Chairman and Members of the Subcommittee, I am pleased to submit this statement concerning H.R. 7340, the Cash Discount Act. This legislation will be of substantial benefit to consumers and merchants alike. The bill does something very simple. It permits merchants to decide for themselves the conditions under which they will offer their customers discounts for paying by cash rather than by credit.

There are many reasons why merchants would want to give cash discounts. Cash discounts will reduce merchant cost by eliminating the fee they must pay credit card issuers. Discounts will also reduce paper work and accounting for merchants and attract new customers because of the lower prices.

Current law imposes so many restrictions on merchants who wish to offer cash discounts that it has effectively discouraged merchants from offering cash discounts. While those restrictions were well meaning and meant to protect consumers, they are like medicine that cures the disease by killing the patient. This bill will revive the cash discount patient without the fatal overregulatory side effects of the present law.

This legislation has wide bipartisan support in the House of Representatives. The legislation was approved by the Full Banking Committee by a unanimous 37–0 vote. At the hearings on this legislation, five of the seven witnesses supported its passage. This included the Federal Reserve Board, the AFL–CIO, Esther Peterson's Office and Consumers Union.

The existing Cash Discount Act has an important consumer protection which prohibits merchants from surcharging credit card use. While I want to encourage discounts for cash customers, I am strongly opposed to penalizing credit customers by surcharging them. It has come to my attention that there are those who would like to repeal the ban on credit card surcharges. I believe that repealing the ban on credit card surcharges would be a grave error.

The ban on merchants imposing surcharges on their customers who pay by credit card is an absolute prohibition that applies whether or not the merchant is attempting to encourage a cash discount. So, whether or not to retain the ban must be viewed in a context that is wider than the cash discount issue. This protection has been in effect since 1976 and has proven to be of tremendous value to consumers.

Last year when it was so difficult to obtain gasoline, gas station owners wanted to, and indeed some attempted to, impose a surcharge on their credit card customers. Once the Department of Energy was informed of the federal ban, the surcharges stopped. This form of price gouging is outrageous. It is outrageous because with certain purchases such as gosoline, a consumer has an absolute need to make the purchase. If unable to pay by cash the consumer would have no alternative but to pay the surcharge penalty.

If the ban on surcharges is lifted, I predict that already hard-pressed consumers are going to find themselves being surcharged in every direction that they turn.

With respect to surcharges and cash discounts, the economic effect of a cash discount or a credit card surcharge is not identical. By illustration, under a discount system, if a merchant sells an item for $10.00 and decides to offer a ten percent cash discount, the cash customer would pay $9.00 while the credit card customer would still pay the $10.00 regular price. In contrast, under a surcharge system if a merchant sells an item for $10.00 and decides to offer a surcharge/discount, the cash customer would pay $10.00 and the credit customer $11.00. Therefore, a cash discount is a reduction in the regular price which provides a benefit to the cash-paying customer and permits the customer who pays by credit card to continue to pay the regular price. On the other hand, a surcharge provides, no economic benefit at all to the customer who pays by cash because he continues to pay the regular price, while the customer who pays by credit card is penalized by having to pay a regular price plus a surcharge.

Creditors and merchants have begged consumers to take as many credit cards as possible and use them as often as possible. They have made use of credit cards a virtual necessity for many consumers. Consequently, credit cards have ceased being a luxury. To penalize consumers for use of credit cards especially in the midst of a serious recession would be cruel and unfair.

Permitting merchants to add on surcharge penalities is particularly unfair now, when the consumers have just been hit with a barrage of increased interest rates, annual charges and other new fees by credit card issuers.

I strongly urge the Subcommittee to approve H.R. 7340, the Cash Discount Act, so that consumers and merchants can enjoy its benefits as soon as possible. I also strongly urge the Subcommittee to retain the current ban on credit card surcharges.

II

96TH CONGRESS
2D SESSION

H. R. 7340

IN THE SENATE OF THE UNITED STATES

JUNE 4 (legislative day, JANUARY 3), 1980

Read twice and referred to the Committee on Banking, Housing, and Urban Affairs

AN ACT

To amend the Truth in Lending Act to encourage cash discounts, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Cash Discount Act".

SEC. 2. Section 167(b) of the Truth in Lending Act (15 U.S.C. 1666f(b)) is amended to read as follows:

"(b)(1) With respect to any sales transaction, any discount offered by the seller for the purpose of inducing payment by cash, check, or other means not involving the use of

an open end credit plan or a credit card shall not constitute a finance charge as determined under section 106.

"(2) A seller shall make known to buyers the availability of a discount the seller offers for the purpose of inducing payment by cash, check, or other means not involving the use of an open end credit plan or a credit card.".

SEC. 3. The first sentence of section 105(a) of the Truth in Lending Act (15 U.S.C. 1604(a)) is amended to read as follows:

"The Board shall prescribe regulations to carry out the purpose of this title, except with respect to section 167(b) and section 171(c).".

SEC. 4. Section 103 and the Truth in Lending Act (15 U.S.C. 1602) is amended by redesignating subsections (x) and (y) as subsections (y) and (z), respectively, and by adding after subsection (w) the following:

"(x) The term 'regular price' as used in section 103 and section 167 means the tag or posted price charged for the property or service if a single price is tagged or posted; or the price charged for the property or service when payment is made by use of an open end credit plan or a credit card if either (1) no price is tagged or posted, or (2) two prices are tagged or posted, one of which is charged when payment is made by use of an open end credit plan or a credit card and the other when payment is made by use of cash, check, or

similar means. For purposes of this definition, payment by check, draft, or other negotiable instrument which may result in the debiting of an open end credit plan or a credit cardholder's open end account shall not be considered payment made by use of the plan or the account.".

Passed the House of Representatives June 3, 1980.

Attest: EDMUND L. HENSHAW, JR.,
Clerk.

By W. RAYMOND COLLEY,
Deputy Clerk.

Senator MITCHELL. Our first witness this morning is the Honorable Nancy Teeters, Governor of the Federal Reserve Board. Governor Teeters, welcome.

STATEMENT OF NANCY H. TEETERS, MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

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

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

The Board has previously testified before this subcommittee on the issue of Federal rather than State law regulating consumer credit matters. As this subcommitte may recall, the Board did not support the bill that prohibits use of the rule of 78's in certain transactions. The Board opposed that bill, not because it believes creditors should continue to use the rule of 78's, but because it believes State regulation is generally preferable to Federal. This preference is based not only on general philosophical principles, but also on the basis of experience in attempting to impose a national, uniform disclosure standard under the Truth in Lending

Act. While the Board does not recommend retreating from the goal of national, uniform disclosure, it is inclined to recommend that substantive regulation be left to the States.

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

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

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

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

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

STATE REGULATIONS PREFERABLE

Senator MITCHELL. In your statement, Governor, you comment that the Board believes that State regulations are generally preferable to Federal, and also make a reference to freeing up the market.

Do I understand that abolishing the prohibition on surcharges would be a step in that direction; that is, it would eliminate existing Federal regulation in that area?

Mrs. TEETERS. As I understand it, the law only permits cash discounts and it does not permit surcharges. So that to that extent, I suppose it would. I am not familiar with the 50 State laws as to whether they permit surcharges or not.

Senator MITCHELL. Now, I reviewed last night and earlier this morning all of the testimony that was submitted and in one of the statements by one of the witnesses, and I will quote, it says, "It is hard to understand how anyone can argue with a straight face that the effect of a surcharge and a discount are identical."

Now you just did that with a very straight face and I wonder if you could elaborate on that?

Mrs. TEETERS. In H.R. 7340 dealing with removing the 5-percent limit on the discount, there is a definition of "regular price." If you're going to give a 5-percent discount for cash thereby charging a cash customer $95, then you must define the regular price as being $100 so as to prevent the $5 difference from being considered a surcharge, which at the present time is prohibited. There seems to me that there are two sides to the same argument. It's just a matter of how you determine what the regular price is.

If you determine the normal price to be the cash price and then add 5-percent, I don't see that that's any different than giving a credit card price of 100 percent and deducting the 5-percent for cash payment.

DISCOUNT RATES

Senator MITCHELL. Also in the written testimony submitted, reference is made to a study conducted earlier this year by Peat, Marwick & Mitchell of credit costs in Massachusetts. That study concluded in part that it was reasonable to expect that any increases in discount rates would be passed on to consumers in the form of higher prices for goods and services.

Considering that statement, is it fair to assume that merchants already pass these discount rates along to all their customers, including cash customers, with the result that cash customers are frequently forced to subsidize purchasers who utilize credit cards?

Mrs. TEETERS. I'm not sure we have a great deal of information on that. We do know that the discount for cash is not very frequent. In all my travels I have never been offered a discount for paying cash instead of using my credit card. So to the extent that the discount is not functioning, then the cash customer is in effect subsidizing the credit card user. The bigger subsidy comes from the people who utilize the credit card for credit over a longer period of time versus the person who pays his credit card off every month and doesn't bear any of the charges.

Senator MITCHELL. Do you think the Peat, Marwick & Mitchell reference to discount rates meant the discount that the retailer or seller accepting the credit card pays to the credit card company, in effect producing a subsidy by cash customers to those purchasers who utilize the credit cards because the retailer or seller receives less in terms of absolute dollars?

Mrs. TEETERS. It seems to me that's probably true. I believe that the merchants who accept the credit cards have done so for com-

petitive reasons. It's a way of serving the customer and this may be why the cash discount has never become very popular; but the amount that is paid to the credit card agency that handles the account obviously is a deduction from the profits, so the cash customer must be adding more to the retailer's profit at that point than the credit card customer.

Senator MITCHELL. Could a merchant administer a surcharge more easily than a discount?

Mrs. TEETERS. We don't have any studies that say whether it would be easier to administer, in a bookkeeping or an accounting sense, than a discount and I changed my testimony to say that we really don't have any information to know whether it is easier to administer or not. We think, however, that it may be an easier idea to market and explain to the customer.

Senator MITCHELL. Well, with respect to a surcharge, if one were permitted, would you favor limiting it to 5 percent or do you favor unlimited surcharges?

Mrs. TEETERS. If it's openly disclosed as the surcharge, then I would think competitive pressure would control it. If you walk into a hotel and they tell you it's going to cost you 10 percent more if you charge on the credit card than if you pay cash, then you're fully knowledgeable as to what you're paying. But if they don't tell you that and you hand over your credit card and they automatically add 10 percent on the bill, that's something else again. I think a lot of it depends on how it's presented as to whether you know it or not.

Senator MITCHELL. Are you aware of the extent to which there have been studies, if any, documenting the degree of rate competition in the bank credit card area, which I understand should be one of the primary factors to be considered by Congress in dealing with the preemption of State usury ceilings?

Mrs. TEETERS. I don't think we have any studies on that. In the consumer area, as I understand it, almost all of the rates are up against whatever the State usury ceiling is. The only consumer credit interest rate that tends to vary cyclically are the ones for automobile people and mortgages.

Senator MITCHELL. Well, let me ask you the second part of that question first. Do you agree that the degree of rate competition in the bank credit card area should be an important factor to be considered in determining whether Congress should preempt State usury ceilings?

Mrs. TEETERS. I'm just not sure there is any competition. My impression is that it goes right up against whatever the State usury is and the most widespread one is 1½ percent a month which compounds out to about 18 percent a year, and there are some different State laws where that 18 percent sometimes gets lower if the balance gets over a certain amount, but I'm not aware that there's a great deal of competition in that.

Senator MITCHELL. So if a witness were to suggest that State usury ceilings should be preempted or abolished because there is vigorous competition in the bank credit card area, I take it that you do not agree with that?

Mrs. TEETERS. I don't think competition is in the rate. I think it's in the services and convenience and the credit limits and things of this sort. I'm not sure it's on the interest rate charge.

Senator MITCHELL. You heard my earlier comments about the Commission and staffing on the most economical basis. Would you, as a representative of the Board, be willing to submit suggestions in writing to me within the next week or ten days on how we could best utilize the Board's services in keeping down the cost of such a commission?

Mrs. TEETERS. I would be delighted to do that. We will certainly give you as much access to data as we possibly can and we would be most happy to do whatever we can do to facilitate the study.

Senator MITCHELL. And could we have that within 7 days?

Mrs. TEETERS. Certainly.

Senator MITCHELL. Many of the opponents of the surcharges who will be testifying here rely at least to some extent on the premise that small merchants would be hurt by the use of surcharges. Are you aware of any evidence that that would suggest that the small merchants would impose surcharges to the extent they would damage their total sales?

Mrs. TEETERS. As I said, Senator, we really don't have any experience with surcharges and we have never put it into the consumer credit survey because it didn't exist, so we're really dealing in an area where we have no information at all as to what the impact would be.

SUPPORTS STUDY COMMISSION

Senator MITCHELL. In your statement you express support for the idea of the Study Commission particularly with respect to open-end credit which has grown so rapidly since the NCCF report was published in 1972.

Many of those who will testify today in opposition to the study will suggest that no further study is needed, that the report in 1972 was very comprehensive and that there have been some additional studies since then.

I gather that you do not agree with that assessment.

Mrs. TEETERS. I understood that this study was really looking to what could be done to bring the State laws up to date. I think that the State laws have changed. The Uniform Consumer Credit Code was never enacted by all the States. We have run through a period of rather wide fluctuations in interest rates and periods in which market rates have been above usury rates, and we saw the credit being shut off to consumers under those conditions.

So I think we have had an experience since then that ought to be related to what is occurring in the State laws and what is needed to bring them into greater conformity.

Senator MITCHELL. Would it be fair to say that there's been a substantial, perhaps even a dramatic increase in open-end credit in the decade of the 1970's?

Mrs. TEETERS. Oh, yes. The use of credit cards for both credit and convenience has grown quite a bit during the 1970's.

Senator MITCHELL. So to that extent a study conducted in the late 1960's and early 1970's and published in 1972 would not be particularly relevant?

Mrs. TEETERS. I think it's relevant, but I think it can be brought up to date and also it's very hard to deal with 50 State laws. You really have to compare them, and I think it would be very useful to know what the States have done in the open-end credit area.

Senator MITCHELL. Thank you very much.

The next witness will be Mr. Frank Jestrab, commissioner of the National Conference of Commissioners on Uniform State Laws; and he will be joined by Mr. John Malarkey, Delaware State bank commissioner and vice chairman of the Federal Legislation Committee of the Conference of State Bank Supervisors. I take it you're Mr. Jestrab.

Mr. JESTRAB. Yes, sir.

Senator MITCHELL. And therefore, you must be Mr. Malarkey.

Mr. MALARKEY. Yes, Senator.

Senator MITCHELL. That must lead to a lot of comments when you testify, Mr. Malarkey.

Mr. MALARKEY. Quite a few, Mr. Chairman.

Senator MITCHELL. Mr. Jestrab.

STATEMENT OF FRANK JESTRAB, COMMISSIONER, NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS

Mr. JESTRAB. My name is Frank F. Jestrab and I am pleased to appear before this subcommittee as a representative of the National Conference of Commissioners on Uniform State Laws. The national conference is a group of practicing lawyers, judges, law professors, and other attorneys with members from each State serving without compensation and appointed by their respective Governors. The conference has been in existence since 1892. Its purpose is to promote uniformity in State law on subjects where uniformity is desirable and practicable. Although I have been with the national conference for over 20 years as a commissioner from North Dakota, my testimony before you today is potentially one of the most important things I have done to forward the goals of the conference.

Prior to 1969, it is often said that there was no significant Federal involvement in the area of consumer financial services law. Certainly, relative to today that is true, even though examples of Federal regulation did exist, such as section 85 of the National Bank Act, which in *Marquette Nat. Bank* v. *First of Omaha Service Corp.,* 439 U.S. 299 (1978), was interpreted to allow a national bank to override a State consumer protection law.

In 1969, the Consumer Credit Protection Act became effective. We tend to think of that act as truth in lending, but even at that early date it included much more. For example, it included Federal restrictions on the maximum amount of wages that might be garnished and on the discharge of an employee for being subject to garnishment, matters that until then had been regulated by State law. By 1980, the Consumer Credit Protection Act covered in addition, fair credit reporting, fair credit billing, consumer leasing, equal credit opportunity, fair debt collection, and electronic fund transfers. Moreover, Federal involvement hardly stops with title 15 of the United States Code. Other enactments that involve or relate to the area are the Real Estate Settlement Procedures Act, the Home Mortgage Disclosure and Community Reinvestment Acts, the

Financial Insitutions Right to Privacy Act of 1978, and, most recently, title V of the Depository Institutions Deregulation and Monetary Control Act of 1980, which peempts State usury laws in connection with residential loans, business and agricultural loans, and loans by federally insured banks, savings and loan associations and credit unions. Finally, of course, there is additional legislation constantly proposed, such as the cash discount and rule of 78's bills. Nor is all the activity confined to the Congress. For example, the Federal Trade Commission in recent years has promulgated or proposed trade regulation rules which relate to door to door sales, the preservation of consumers' claims and defenses, and a wide variety of credit practices from obtaining cosigners to security interests. While this list is hardly exhaustive, it does give an idea of the extensive development in the decade just past.

THREE SIGNIFICANT ISSUES

Three rather significant issues have grown out of this development. The first is what sort of a regulatory structure should exist pursuant to these enactments on the Federal level. Presently, some of the Federal acts give rule writing authority, some do not, and, in the case of the FTC, it exists subject to congressional veto. In many cases, enforcement is separated from rule writing. This has lead to conflicts between Federal agencies and other undesirable consequences as described by Professor Rohner in an article appearing at 35 Business Lawyer 135 (1979). There seems to be no clear policy with respect to the present time even though there is much discussion.

A second issue is the relationship between the Federal activity and similar State laws. Recognizing that many, if not most, of the subjects I previously mentioned were the subject of at least some State action, Congress in many acts adopted a more limited preemptive position than might otherwise have resulted. Further, in many of the statutes, it also allowed the Federal Reserve Board to exempt classes of transactions within a State from the actual provisions of the Federal law, if State law was substantially similar and there was adequate means for enforcement. Presently, five States have an exemption from the Truth in Lending Act and, interestingly, three of them—Maine, Oklahoma and Wyoming—have a uniform statute on the subject prepared by the national conference. Later enactments by Congress have been less generous; after all there is little else you can do when you are going to override a State usury law. But even here the States have been given a period within which to act, and divorce themselves from the Federal law. In the usury area, Hawaii recently has done just that. Yet, in other areas, similar State laws have been summarily wiped out, as in the cases of the FTC trade regulation rules on door to door sales and preservation of claims and defenses. Again, there seems to be no clear or consistent policy on this issue, but only a series of decisions perhaps appearing sensible at the time.

Finally, there is the issue of how far to go. Much of the Federal legislation up until the end of the decade did not, perhaps, directly raise this issue, because each law seemed self-contained and a logical and desirable addition to the ones before. Nonetheless, there were indications that self-containment was perhaps illusory as, for

example, in the impact of the Equal Credit Opportunity Act on State cosigner laws, loan splitting laws, age of majority laws, and numerous other laws. And, of course, the overall volume began to aggregate a good portion of the total pie. But the recent and proposed excursions into the area of rates of finance charge and matters related thereto, such as rebates and permissible security, have forced direct consideration of this issue. The Congress recognized the issue in title V of the Depository Institutions Deregulation and Monetary Control Act when it explicitly tied preemption of State usury laws relating to residential manufactured homes to provisions regulating balloon payments, prepayment penalties, late charges, deferral fees, notice before repossession and rebates. Does this recognition suggest that Congress, if it enacts any further rate legislation, will now begin to develop a national consumer credit code?

The answer to that question is, of course, a part of the matter under consideration by this subcommittee. It is now time, if not past time, to think about each of these issues, as well as others, and to develop national policy in this area, not piece by piece, but in a coherent, prospective manner. Some of this has already been initially formulated in the report of the National Commission on Consumer Finance published in 1972, but 8 years in this area is a very long time, much has changed or developed, and more needs to be done. The national conference strongly supports the creation of a study commission, which would update the National Commission report and articulate the broad principles of national policy in this area, by a reasonable future date.

The effectuation of the national policy, once it is formulated, is certainly of no less importance. There is no question that, as in the past, this will likely be a shared responsibility between the Federal Government and the States. The national conference has over 80 years' experience drafting State legislative proposals and has a mechanism to assist those proposals in becoming State law. As it is obvious from the activity of the Congress, and even from activity in the national conference itself, that a large degree of uniformity in this field of law is desirable, a recommendation will be made to the national conference at its annual meeting, beginning this Saturday, that it, too, appoint, a study committee to consider both the proper form and scope of State action in the area of consumer financial services law. The ultimate decision to enter into further work based on this recommendation will have to be made by the national conference executive committee, and will depend upon the time, money, available substantive resources, and outlook for a successful project. But if these matters can be successfully resolved, the States, as well as the Congress, will begin to act concurrently.

UNIFORM STATE ACTION

One last question should be addressed: Is uniform State action practicable? Frankly, if the Federal Government wishes to effectively shoulder the whole responsibility, the answer is clearly no. All that has transpired so far, however, gives no indication that this is Federal policy. In the absence of a completely preemptive stance, there are numerous examples of where uniform State action has been accomplished before, perhaps the best of which is

the uniform commercial code, now the law in 49 States and even partly in the 50th State. What has occurred before can occur again, and the Federal Government and the States, working in partnership can preserve the best of federalism in this area of the law. The national conference always proceeds with that approach in mind and will give careful consideration to the work of the proposed study commission.

Thank you for allowing me to address you concerning this important subject.

Senator MITCHELL. Thank you, Mr. Jestrab. Mr. Malarkey.

STATEMENT OF JOHN MALARKEY, DELAWARE STATE BANK COMMISSIONER, VICE CHAIRMAN, FEDERAL LEGISLATION COMMITTEE, CONFERENCE OF STATE BANK SUPERVISORS

Mr. MALARKEY. Mr. Chairman, I am John E. Malarkey, State bank commissioner for the State of Delaware, and vice chairman of the Federal Legislation Committee of the conference of State Bank Supervisors on whose behalf I am appearing today. The conference is the nationwide organization of State officials who serve as the primary chartering, examining and regulatory authorities for approximately 10,500 State-chartered commercial and mutual savings banks with total assets of approximately $500 billion.

My comments this morning will focus on the proposal to establish a Consumer Usury Study Commission. Although I am not aware of the full details of your proposal, the conference is very concerned about Federal preemption of States in the usury area and the need for a broader recognition of the efforts of States to establish greater flexibility in the lending area in order to meet the credit needs of their residents.

I note that your proposed Study Commission would be directed to the question of Federal preemption of State usury ceilings and to possible alternatives to further Federal preemption as well as to a number of other related areas. The conference always has stressed its position that in setting usury ceilings, the States are in a better position to more responsively reflect the needs of their respective citizens than is the Federal Government. That is still our basic position, even though we have seen in recent months usury ceilings in a number of States become anachronistic, in part because of underlying conditions over which States had no direct control. I refer specifically to inflationary monetary policies of the Federal Reserve System in the past, coupled with periods of high budgetary deficits of the Federal Government, which have contributed to this high interest rate dilemma for several States. As a result, what otherwise might have been reasonable usury provisions have become unduly burdensome constraints in a number of States. While I do not pretend that all States have acted as promptly as some might desire in updating their various usury statutes, it is of interest to note that during the period from December 1975 to November 1979 some 38 States have liberalized their usury ceilings, 1 or more times.

In testimony before the Senate Banking Committee last December, the Conference, in considering the emergency nature of the interest rate situation in some States, was supportive of the thrust of S. 1988, a bill which would have permitted State banks to charge

1 percent over the discount rate irrespective of State constitution or law. Our support of the bill, however, was conditioned on the fact that the Federal override of State usury provisions should be temporary, in that there should be sunset provisions to the Federal preemptive features in the usury area. Furthermore, we stressed that the States should have a right during the period of the Federal override to enact legislation reasserting their own usury laws if they considered such action to be in the best interest of their residents. That testimony is reflective of our present position, that is, that the States should have the final authority with respect to determining usury ceilings within their borders. We simply do not believe that national norms which require all States to adopt a uniform pattern determined in Washington is necessarily in the broadest public interest. We believe that State officials, operating with first-hand knowlege of local situations, are in a much superior position to serve the varied needs of communities throughout our country.

USURY PROBLEMS AND SOLUTIONS

Federal and State usury problems and solutions, within the context of Federal preemption of States, must be placed in proper historical perspective. Recent Federal preemption efforts have implied that States are and always have been the sole villain in the usury scene and that the Federal Government must be chosen as the hero to rescue society from irresponsible State statutes and regulations.

Examination of the facts raises serious questions about the validity of those implications. Over the years, the Federal Government has played a leading role in establishing usury ceilings below private free market rates. The Farmers Home Administration and Federal Housing Administration are examples. Further, it must be recognized that CSBS and individual States were moving toward greater flexibility in usury statutes years before it became politically fashionable for Federal officials to do so. It was not until Federal monetary and fiscal excesses pushed inflation and free market interest rates astronomically high that Federal officials jumped on the bandwagon as born-again free marketeers in a frantic effort to appear to be the solution to a usury problem they themselves largely created.

In this whole exercise of correcting the usury problem it must be remembered that it is largely a Federal Government created problem and that CSBS and individual States were taking steps to alleviate the problem before it became politically expedient for Federal officials to do so. This suggests that States can be expected over time to act at least as responsibly as Federal officials, which in turn raises serious questions about the wisdom of Federal preemption of State statutes.

The conference is wholeheartedly in agreement with your observations, Mr. Chairman, that the question of usury ceilings is a highly complex and controversial one. We have seen how usury ceilings, no matter how well intentioned, and irrespective of whether or not they have been imposed by States or the Federal authorities, represent artificial restraints on otherwise free credit flows when prevailing market rates exceed such ceilings. We have seen

how distortions in credit flows result from anachronistic usury ceilings and how such distortions can have grave and adverse consequences for economic activity. Because of the complexity of this issue, it is believed that a 1-year study commission, the broad operating outline to which you have referred in your letter of July 18 to the conference, could serve a very useful purpose in safeguarding against hasty or ill-conceived Federal legislation in the usury area.

We are particularly pleased that among the proposed Commission members would be two officials of State agencies which regulate banks and a third State official who has responsibility for regulating consumer credit. We believe that an input from well-informed State officials would be very useful because we have seen a distressing tendency to centralize authority in a number of banking areas which we believe properly belong to the States. Furthermore, it would appear that regional hearings on these broad issues, as you have proposed, would also be helpful in revealing local needs, and in highlighting the differences that do exist in our great country as to credit needs and the basic philosophies for meeting such credit needs.

Thank you, Mr. Chairman.

Senator MITCHELL. Gentlemen, that last buzzer you heard means there's a vote on the floor of the Senate, so we will have to recess briefly while I go over and vote. When we come back I would like to ask you a few questions. So we will be in recess for a brief period of time.

[Recess.]

Senator MITCHELL. Thank you for bearing with me, gentlemen.

FAVOR STUDY COMMISSION

Let me ask you both to comment to this question. Most of the credit representatives who will appear here today will testify in opposition to any study commission contending that it is not necessary, that there have been plenty of studies done, but one suggests that if such a study is approved it should be conducted by an existing group of Federal officials, an interagency committee, not by a national commission made up of various interested parties and therefore no one representing the States.

Would you care to comment on that approach? Do you feel that another study by Federal officials exclusively, without any participation by State officials, would be desirable?

Mr. JESTRAB. Well, Mr. Chairman, we are strongly in favor of the proposed Study Commission. We, of course, are dedicated generally to State action and we believe that in the federation that there is still a large area where the States can act and act very effectively, and one of the best illustrations of this is the uniform commercial code which I alluded to. There is a very good example of an area where national uniformity is highly desirable; it's a complex area; and yet the uniform commercial code, which is a product of the conference, has fulfilled this need and we believe that it's also an area in the consumer credit where the same thing would be true, but we think that this subject is most worthy of the further study and we think anything else would not be as effective.

Senator MITCHELL. Mr. Malarkey?

Mr. MALARKEY. Mr. Chairman, it would be the conference's opinion, as I stated in my testimony, that we would welcome a commission and are very desirous of having State officials represented on it. We think that the States deserve some say in what's going to happen.

Senator MITCHELL. And I gather from your statement that you agree with Mr. Jestrab that you don't think that further Federal preemption, particularly on the ad hoc basis in which it's occurred, is justified or necessary at this time?

Mr. MALARKEY. No, we do not, sir.

Senator MITCHELL. You feel there is a legitimate role for the States to play in this area?

Mr. MALARKEY. Yes, and I think we can prove, Mr. Chairman, that many States have already acted. In my own State of Delaware, we completely indexed every interest rate in the Delaware code in April and we just don't have that ceiling problem.

Senator MITCHELL. Well, what about the argument that's going to be made that there are already all kinds of studies; there is plenty of data in the field; that we don't need any more studies? Is there sufficient data?

Mr. MALARKEY. Well, I'm not certain, Mr. Chairman, that I know how many studies have been made. What I have heard so far indicates that the last one or the last comprehensive one was issued in 1972 and that's 8 years ago, sir, and there's been a lot that's happened since then.

Senator MITCHELL. Do you agree with Governor Teeters' observation that there has been a dramatic growth in open-end credit in the decade of the 1970's?

Mr. MALARKEY. Absolutely, Senator.

Senator MITCHELL. And do you agree with that, Mr. Jestrab?

Mr. JESTRAB. Yes, sir.

Senator MITCHELL. Thank you both. I appreciate your appearance here today.

The next witnesses will be Mr. Leonard F. O'Connor, vice president of the First National Bank of Boston, representing the Consumer Bankers Association; and Mr. Jack Fox, senior vice president, United Virginia Bank Shares, Inc., Richmond, Va., representing the American Bankers Association.

Good morning and welcome, gentlemen. I assume that you, sir, are Mr. O'Connor, and that means you must be Mr. Fox.

Mr. Fox. Yes, sir.

Senator MITCHELL. Perhaps you can introduce your associate with you today.

Mr. O'CONNOR. Accompanying me today is Mr. Peter Schellie, a partner with the law firm of Baker & Daniels.

Mr. Fox. And I'm the lone fox.

Senator MITCHELL. You're the lone fox? It kind of looks to me from your statement that you might be called a sly one, too.

Mr. Fox. No, I don't think so.

Senator MITCHELL. Why don't we proceed then. Mr. O'Connor, would you like to proceed first?

STATEMENT OF LEONARD F. O'CONNOR, VICE PRESIDENT, FIRST NATIONAL BANK OF BOSTON, REPRESENTING CONSUMER BANKERS ASSOCIATION; ACCOMPANIED BY PETER D. SCHELLIE, ESQ., BAKER & DANIELS

Mr. O'CONNOR. Thank you, Mr. Chairman.

Senator MITCHELL. Mr. O'Connor, before you proceed, I read your entire statement last night, which as you know is 26 pages long.

Mr. O'CONNOR. Yes, I know.

Senator MITCHELL. The entire statement will be put into the record. In the interest of time and hearing others, would you be able to summarize it?

Mr. O'CONNOR. We have condensed it.

Senator MITCHELL. All right. Then we'll put the whole statement in, but I have read it.

Mr. SCHELLIE. I believe a copy of the oral testimony is at the desk.

Senator MITCHELL. Of the summary?

Mr. SCHELLIE. Yes, sir.

Senator MITCHELL. That would make it easier for me to follow. All right. Why don't you proceed, Mr. O'Connor.

[Complete statement follows:]

STATEMENT OF LEONARD F. O'CONNOR ON
BEHALF OF THE CONSUMER BANKERS ASSOCIATION
BEFORE THE SUBCOMMITTEE ON CONSUMER AFFAIRS
OF THE SENATE COMMITTEE ON BANKING, HOUSING
AND URBAN AFFAIRS CONCERNING THE CASH DISCOUNT
ACT AND THE CONSUMER USURY STUDY COMMISSION

Mr. Chairman, other distinguished members of the Subcommittee, I am Leonard F. O'Connor, Vice President of The First National Bank of Boston, Boston, Massachusetts. I serve as Chairman of the Government Relations Committee and am a member of the Executive Committee of The Consumer Bankers Association.[1/] The Consumer Bankers Association greatly appreciates this opportunity to present testimony concerning H.R. 7340, the "Cash Discount Act," and your proposal to introduce legislation establishing a Consumer Usury Study Commission.

The Association generally supports the Cash Discount Act with two important qualifications. First, the Association believes that the removal of the 5% cash discount limitation must be tied to a permanent ban on the use of credit card surcharges. Second, the Association believes that consumer

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1/ The Association is a nonprofit organization that was organized in October 1919 to provide a voice for the consumer banking industry. Since that time, the membership of the Association has grown to over 330 commercial banks of all sizes that are actively engaged in extending consumer credit. Combined, the members of the Association now hold over 55 percent of all consumer credit outstandings held by commercial banks. The members' consumer credit outstandings total more than $72,000,000,000.

protection provisions must be inserted into the Act to prohibit the selective or discriminatory availability of cash discounts.

In light of the substantial amount of study and analysis that has been done in the usury area and the expertise of existing governmental entities, the Association feels it must oppose the creation of a Consumer Usury Study Commission. We believe that to establish another federal entity would be costly, inefficient and unnecessary given the extensive volume of information currently available to the Congress. These materials include a final report and accompanying voluminous technical studies that directly addressed the usury issue. This report was prepared by a distinguished national commission -- that had as members Senators Proxmire, Tower and Sparkman -- which completed its four-year study less than a decade ago. If non-Congressional consolidation of this information is deemed necessary, the Association recommends the utilization of the recently used interagency task force mechanism made up of participants from several existing federal government agencies. If a new governmental entity is to be created, the Association will suggest several important changes in its composition, purpose, duration and function.

I. CASH DISCOUNT ACT (H.R. 7340)

A. The Current Status Of The Law

Several years ago, virtually all merchant agreements involving credit cards contained prohibitions against the offering of cash discounts or the imposition of surcharges in conjunction with credit card transactions. These provisions were considered to be particularly important since they prevented merchants from pricing credit card programs out of the market. They were also designed to prohibit any bias against those who used credit cards to purchase goods and services.

In 1974, the Truth in Lending Act was amended to eliminate merchant agreement provisions that prohibited merchants from offering discounts to a customer who paid by cash, check or similar means rather than by use of a credit card. The amendment also provided that discounts not exceeding five percent that were clearly and conspicuously offered to all prospective buyers would not constitute a finance charge for disclosure purposes. In 1976, the Truth in Lending Act was further amended to prohibit a seller from imposing any surcharge on a customer who elected to use a credit card instead of payment by cash, check, or similar means. This prohibition, however, had a sunset provision providing a February 27, 1979 expiration date. That date was extended in 1978 so that the provision will now

expire on February 27, 1981. The Federal Reserve Board, through Regulation Z, promulgated rules to implement these requirements.

B. Changes Made By H.R. 7340

H.R. 7340 would make four changes in the existing law. First, the bill would add to the statute a slightly modified Truth in Lending Act definition of "regular price," which now is contained in Regulation Z. Second, the bill would remove the five percent limit on cash discounts. Third, the bill would prohibit the issuance of regulations by the Federal Reserve Board in connection with these provisions. Fourth, the bill would eliminate current requirements that the discount must be offered to all prospective buyers and that its availability must be clearly and conspicuously disclosed. I would like to address each of these changes in order.

1. Definition Of "Regular Price"

The Association supports including the definition of "regular price" in the statute in order to establish a clear benchmark price from which a discount can be calculated. Simply stated, the regular price would be the tag or posted price charged for the item when one price is quoted, or the price charged for the item in a credit transaction if no price is posted or where two prices are posted, one for

credit and one for cash. The definition also makes clear that the use of personal checks that draw on a line of credit under an overdraft plan would not be a credit transaction.

The Association has one concern with the inclusion of check payments within the discount provision. Very often payment by check is less efficient and more expensive than payment by cash, both for the consumer and the financial intermediary. The handling of any paper instrument requires a cost that ultimately must be borne by the consumer either visibly in the form of a check charge or an account service charge or less visibly through reduced interest earnings or services. Indeed, for many consumers, the use of credit cards can be cheaper than the use of checks. These consumers use their credit cards as a convenient way to "pay" for items immediately and then pay their card balances in full during the "free periods" without incurring any finance charges. Those consumers who choose to use credit cards as an alternative -- and less expensive -- payment mechanism would be penalized. We believe that at a time that innovative alternative payment mechanisms are being introduced, serious problems and probable consumer confusion will result from establishing different sets of pricing rules for different but very similar payment methods. Moreover, to

the extent that consumers are encouraged by federal law to use less efficient, more expensive or less safe methods of using our financial system, the Association does harbor some reservations about this bill.

2. Unlimited Cash Discounts

The Association supports the elimination of the five percent limit on cash discounts. There is strong sentiment that this provision is favorable to consumers and that it allows merchants to decide for themselves the extent to which they should provide a cash discount. The Association strongly believes, however, that this change must be linked to a permanent ban on surcharges.

The cash discount provision encourages cash and carry transactions to help reduce inflationary pressures. Cash transactions can be beneficial to the consumer and to merchants.[2/] The purpose must not be (1) to discriminate against credit purchasers, especially those consumers who do not have cash available and must depend upon credit, by adding a surcharge to the regular price or (2) to create a system in which credit purchasers subsidize a cash

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2/ For consumers, the availability of unlimited discounts is a real incentive for paying in cash. To the extent merchants can convince customers to pay cash for smaller ticket items, there will be an increase in the overall efficiency of credit card processing operations.

discount system.[3/] A permanent extension of the prohibition against surcharges would prevent these problems without undermining the purpose of the Cash Discount Act. The Association believes strongly that any increase in permissible discounts must be conditioned on making the surcharge ban permanent.

3. Removal Of Rulemaking Authority

The bill also would prohibit the issuance of implementing regulations by the Federal Reserve Board. The apparent rationale is that Regulation Z hindered cash discount

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3/ When Congressman Frank Annunzio introduced a bill to prohibit surcharges in 1975, he stated:

> Unfortunately, there are those who claim that a surcharge to credit card users is economically identical to a discount to cash customers and consequently, a merchant should be permitted to add on a surcharge instead of reducing a regular price by a discount.
>
> It is hard to understand how anyone can argue with a straight face that the effect of a surcharge and a discount are identical. ****
>
> Surcharges would penalize credit card users for no valid reason. Surcharges could cost consumers billions of dollars. Merchants contract with credit card issuers to accept their cards for the substantial benefits they receive. These benefits are that the credit cards increase the volume of business for merchants and allow extensions of large amounts of credit with no risk of loss to the merchants. So, the cost of credit cards to merchants is offset by the financial benefits.

programs and that the Act is simple and easy to understand and implement without regulations. The Association has long held the view that there is too much regulation of consumer credit and generally favors deregulation. However, in areas involving technical duties that are subject to civil damages (although admittedly not statutory damage liability), some regulations are necessary to provide certainty and guidance to those who must comply.

For example, the Cash Discount Act provides that "a seller shall make known [to consumers] the availability of a discount." Either the statute or regulation should clarify the nature and scope of this provision (1) to help merchants comply with it, (2) to limit the possibility that a court would impose civil liability for inadequate disclosure, and (3) to provide standards for the regulatory agencies to use in the administrative enforcement and interpretation of this requirement. While an absence of regulations would be desirable, so long as technical statutory requirements are imposed, the Association believes that there will be a need to define and refine the precise scope of those requirements.

4. Potential For Allowing A Discount On A Discriminatory Basis

The bill also would eliminate the requirements that the discount be offered uniformly to all prospective customers and that its availability be clearly and conspicuously disclosed. The Association believes that these

changes could invite discriminatory discounting practices by some merchants. For example, nothing in the amendment would appear to prevent a merchant from offering a discount selectively on a customer-by-customer basis. The Association suggests that the bill be amended to require merchants who decide to offer discounts to offer them to all prospective buyers. Moreover, by requiring the merchant to disclose the availability of a discount clearly and conspicuously, consumers would know whether they were entitled to a discount, thus reducing significantly the possibility of discriminatory discount practices.

Subject to the changes the Association has suggested to modify, and we feel improve, the Cash Discount Act, the Association supports this timely legislation.

II. THE PROPOSED CONSUMER USURY STUDY COMMISSION

The letter inviting our participation in this hearing specifically invited our comments on the possible formation of a national commission to study state usury laws. The Association has consistently taken the position that artificial governmental controls on the rates and fees charged in credit transactions reflect inefficient and outmoded concepts of consumer protection. Extensive studies undertaken over the last two decades reveal the deficiencies in the arguments originally advanced in support of usury limits. We believe that these analyses provide a very

substantial information base from which legislation could be formulated. We are simply unable to identify the need for extensive reevaluation that merely duplicates information and reports that are currently available. If an attempt is to be made to compile this data, existing agencies using their staff and other substantial resources and expertise should be utilized. The Association respectfully submits that a new entity -- with its incumbent delays and expense -- is simply not called for in these circumstances.

In discussing this area, we would like first to address briefly the background of usury in order to provide some historical perspective on the issue under consideration. Next I will refer to some of the many studies and analyses that have been made in the usury area, and then I will note some reasons for our concern about the creation of a new entity of any kind. If, however, the Committee determines that a non-Congressional fact-gathering mechanism is necessary, we would like to suggest an alternative approach in the form of an interagency task force approach that would allow an expeditious analysis by those who are already familiar with the issue and its many ramifications.

A. The Background Of Usury

Historically, usury limitations were founded upon moral and religious grounds that reflected a noncommercial society in which lending was an extraordinary, rather than

typical, event. Under ancient Biblical teachings, usury -- a term that applied to all lending involving the charging of interest at any rate -- was looked upon as a distasteful taking of advantage of the poor by the rich. As the commercial experience developed, however, lending was perceived as being an increasingly appropriate form of commerce and resulted in a series of laws that were responsive to the relatively undynamic economic situation of the times in which they were adopted. These statutory provisions incorporated rate ceilings that were, at the time of adoption, reasonable in relation to market forces and costs of lending.

Since that time, lending of all types -- including consumer lending -- has been converted from an activity limited in both scope and constituency to one of importance to virtually all consumers. These changes have been reflected in a number of modifications of traditional usury limitations, at both the state and federal levels. Given the rapid changes in the costs included in interest rates, the increasingly national character of lending and the major role already played by the federal government in the regulation of consumer credit, these changed circumstances should be recognized and addressed at a national level. A perfect example of the role suggested for the federal government in issues directly affecting the cost of credit is contained in S. 2002 now pending before this Committee. That bill

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would restrict severely the availability of the "Rule of 78's" rebate method, reducing income to creditors who often are unable to recoup their losses due to usury ceilings.

Congress in 1933 established a maximum interest rate ceiling for national banks, thereby preempting state usury laws that were below that level. This acceptance of usury as a national concern was most recently demonstrated in Title V of the Depository Institutions Deregulation and Monetary Control Act of 1980, which contained provisions overriding some state usury laws. That law overrides, at least to some extent, state usury rates on mortgage loans, large commercial and agricultural loans and all other loans made by state-chartered commercial banks. The latter provision merely provides increased equality for state-chartered, federally insured financial institutions, essentially giving them the same level of preemption enjoyed by national banks since 1933.

In summary, Mr. Chairman, usury laws were adopted in response to moral and religious attitudes that reflected a noncommercial, noncredit society. When enacted and as infrequently revised to provide exceptions or special rules for specific creditors or types of credit, they reflected pending economic conditions -- including the market rates, absolute money cost factors and other costs. These factors simply cannot be reflected through any form of fixed price controls, including those on interest rates. The basic

changes in the society -- the scope of credit needs and use, and the awareness and sophistication of consumers -- have been reflected in a multitude of ways. If reasonable availability of credit is to continue, these changes must be recognized in the area of consumer credit and long held, but arguably obsolete attitudes and justifications must be rejected.

B. Numerous Studies Have Already Examined Usury And Its Effects In Great Detail

Over the past two decades, usury, its underlying rationale and its effects have been the subject of extensive examination and study. These analyses by the private sector and government have included focuses on the geographical distributive effects of different levels of usury ceilings; impacts on various segments of the credit industry; studies regarding its impact on consumers, particularly the less affluent and first-time credit users; examination of dramatic increases in costs viewed against the backdrop of a static rate limit, with particularly significant findings in the credit card areas; exhaustive empirical research regarding traditional economic theories advanced to support usury; close monitoring of consumer attitudes and awareness, which reveal how effectively the market mechanism, would operate in the absence of artificial rate ceilings; and many others.

In short, the subject matter has been surveyed, studied, analyzed, monitored, examined and reviewed from virtually all angles. A few specific examples may be helpful.

Those supporting usury laws seem to rely upon various economic arguments that this recent period of extensive study has refuted. Reduced to their basic elements, only a few economic arguments are advanced in support of usury laws. The first is that the credit-granting industry is closed, small and noncompetitive, so that the removal of usury ceilings would produce unreasonably high credit costs and, incidentally, exclude the "necessitous" borrower. Using various indicators of competition, most studies conclude that the credit industry is highly competitive. Several reports reveal that in areas with usury ceilings that operate above market levels, interest rates are not set at the ceiling but at a lower, market-regulated level. In addition to this evidence of rate competitiveness, another measure is a market characterized by a large number of active competitors. A large number of competitors lowers the risk of collusion and rate setting. The credit industry is characterized by a large number of credit outlets -- everything from credit unions to commercial banks to credit retail sellers. All of these "outlets" then create a broad array of options for borrowers.

A second argument is that consumers are unsophisticated in credit matters and unaware of credit costs, and thus, would be susceptible to exploitation and unable to take advantage of any competition that might exist in the

marketplace. It seems beyond reasonable dispute that over the past two decades, there has been a vast increase in the credit awareness and sophistication of today's consumer. It should be emphasized that even a small group of consumers -- estimated at between 10% and 50% -- who are aware and shop for credit should be sufficient to "police" the market by forcing all creditors, who cannot distinguish between aware and unaware consumers, to compete for this marginal group, consequently benefiting all consumers.

Credit awareness is far greater than necessary to foster competition -- and it is growing. A 1978 study of California cardholders found that over 80% of those surveyed knew the annual percentage rate. This compared with an awareness rate of 26.6% for other bank credit card users surveyed in 1969. Nationally, in 1977, 71.3% of the surveyed consumers were aware of interest rates charged in connection with bank credit cards, while 54.5% were aware of installment interest rates. This phenomenal increase in awareness is primarily the result of the federal Truth in Lending Act. This awareness encourages competitiveness by quickly translating lower rates -- offered to consumers who are aware of market rates -- into more customers.

A third basis for support -- apparently founded on assumptions contrary to the first two -- is that ready access to credit encourages consumers to overuse credit, get themselves in "over their heads," resulting in bankruptcy

and other economic and social disruption. Despite unsupported claims to the contrary, there is little evidence to suggest that consumers have overburdened themselves with credit. On the contrary, consumers continue to be sensible in their use of credit and continue to show their ability to manage debt. For example, the ratio of liquidations to disposable personal income has been declining since the third quarter of 1978. In addition, the growth in installment debt outstanding has been found to merely match the inflation rate. Moreover, part of that growth is attributable to convenience and not necessitous borrowing. Finally, one study concluded that by the end of the third quarter of 1979, consumers had increased their financial assets alone by $84 billion more than their increase in total liabilities.

In this extensive series of reports, surveys and studies, researchers have identified and shown a number of negative impacts produced by usury laws. Usury restrictions limit the availability of credit. Studies have found that the average number of loans and the dollar amount of loans are substantially lower in low-ceiling states than in high-ceiling states. In addition, evidence has shown that in states where free market rate is above the ceiling, the poor, the transient, the young and those with large families are rationed out of the credit market first, since financial institutions must utilize nonprice methods to decrease risk

and increase effective yields. In concluding that previously acceptable but higher-risk consumers are denied the use of credit, one researcher found that 96% of the families that would be excluded if the creditor reduced the risks it was willing to take had incomes below $7500.

These studies have also extended to specific analyses of the economic impact of static rate ceilings in an industry characterized by dynamic changes in costs. Illustrative of the significant problems created by this situation is the difficulty being faced by credit card programs. One study of bank credit cards conducted in my state of Massachusetts by the highly respected firm of Peat, Marwick, Mitchell & Co. revealed that the banks surveyed lost $13.84 on each credit card account. On a transaction basis, each time a consumer used his or her bank credit card, the bank lost 81¢. The cost calculations reflected in that study indicate that, in order for a bank to break even, its cost of funds would have to be 6.68 percent -- a cost of funds level that has not been available for some time.

The study of usury has also been carried out by governmental agencies. In 1968, Congress established a nine-member National Commission on Consumer Finance. The Commission was composed of three appointees each from the President, the Speaker of House and the President of the Senate. Four years later, the National Commission filed its final report that included extensive analysis and recommendations regarding usury. Among the five detailed volumes of technical studies

that accompanied this final report was one that analyzed fully the usury question. In its Summary Recommendations, the Commission advocated raising or eliminating interest ceilings after procompetitive measures were undertaken. The Commission noted that "[a]s the development of workably competitive markets decreases the need for rate ceilings to combat market power in concentrated markets, such ceilings must be raised or removed." The National Commission reached conclusions and reviewed economic and social concerns that are no less valid in July 1980 than they were in December 1972.

Since that major effort, Congress has created another fact-gathering mechanism and has received its report only a month and a half ago. The Interagency Task Force on Thrift Institutions recommended in its June 30, 1980 report that Congress give serious consideration to an override of state ceilings on interest rates charged on secured and unsecured cash loans, credit card transactions, overdraft loans and other, similar forms of consumer lending. In addition to the finding, the Task Force noted that the historic rationale of usury laws, to protect the consumer from unscrupulous lenders, was no longer valid except for parts of the country where credit markets are not yet reasonably competitive. In addition, the Task Force found that usury ceilings have a number of undesirable economic effects:

1. usury ceilings deny credit to low-income consumers;

2. usury ceilings have a depressing effect on the economies of states with binding ceilings;

3. usury ceilings distort the geographic distribution of credit and commerce;

4. usury ceilings divert credit flows among lenders;

5. usury ceilings impose the societal costs of their legal and illegal circumvention; and

6. usury ceilings decrease the options available for consumer borrowing.

These are only a few of the studies, reports, surveys and analyses that have already been undertaken in this area. The field is virtually cluttered with data and materials dealing with the disclosure and adverse effects of usury laws. Additional study and analysis at this point would truly be -- to use an over-worked phase -- reinventing the wheel.

The Association believes that Congress should move to release credit costs from state price controls. Existing materials introduced through the traditional Congressional hearing process would provide more than adequate information for legislative deliberation and action. A commission is simply not needed.

C. The Consumer Usury Study Commission Would Not Provide A Timely Efficient Answer To The Usury Problem

The Association is opposed to the creation of a new federal entity to study usury because more efficient and timely methods exist for assembling the information necessary for Congressional action.

1. Efficiency

The proposed legislation would create a new commission, charged with spending a year and a half studying the question of usury. The Association would respectfully submit that existing governmental agencies and entities could more effectively and efficiently be used to accomplish the same result.

The creation of a new entity would involve substantial delay and expense, both of which could be avoided by utilizing existing information and resources. Purely mechanical questions of staff, office space, office equipment and the likes will waste time that the time-critical usury issue can ill afford.

Moreover, the process of establishing a separate credit commission has proven to be unmanageable in the past. The National Commission on Consumer Finance, established in 1968, twice had to ask the Congress for additional time and once for additional funds. Even with these further extensions and appropriations, the Commission submitted its final report in 1972 long before the completion of several

key studies -- a process which disturbed more than one Commission member -- including Senator Proxmire.

The shape and nature of government seems to make inevitable that any new commission would encounter the same budgeting and time constraints. Together with the inevitable changes in membership, these forces help to create a bureaucratic agency with a life and purpose of its own.

2. Timing

The Association believes that the magnitude of the problem created by state usury laws suggests the need for expeditious Congressional action. A prompt review of and response to the difficulties being faced by banks and other creditors seems inconsistent with the time frame that would necessarily be involved with the creation of a commission.

As a practical matter, it would appear highly likely that the sheer mechanics of establishing a commission could require a substantial amount of time. The selection of the members of the commission, interviewing and hiring staff, obtaining office space, securing everything from typewriters to pencils, will clearly involve many months.

In addition, Mr. Chairman, the period provided to the commission as proposed in your letter seems to be either too short or too long. If the commission is to undertake basic research, data collection and analysis -- efforts we believe to be completely duplicative of existing materials and studies -- the one-and-a-half-year term seems too short.

As noted, similar efforts by the National Commission on Consumer Finance took over four years.

If, on the other hand, the task were to be limited to collecting and reviewing existing information, it seems that one and a half years is too long and that, conceivably, the assembling and organization of the commission could take longer than the substantive project itself.

3. Necessity

Perhaps more important, as detailed above, a commission is simply unnecessary. The subject of usury has been thoroughly analyzed in a broad array of economic journals, detailed studies have been conducted and federal commissions and task forces have probed the area. Such a pulling together of research and experts is ideally suited to the committee system of the Congress -- not for a commission and a large staff.

Summary

The Association opposes the creation of any new commission to study state usury laws. We would urge a careful Congressional consideration of information that is currently available. Rather than selecting a commission format which, in this area, has been plagued by both time and cost overruns, we would urge the utilization of the traditional Congressional mechanism to efficiently analyze this important issue.

D. If An Additional Fact-Gathering Device Is Needed, An Interagency Task Force Should Be Used

The proposed legislation would create a new Commission, charged with spending a year and a half studying the question of usury. The Association would respectfully submit that existing governmental agencies and entities could more effectively and efficiently be used to accomplish the same result.

The approach that we would suggest is identical to the one used in Section 406 of the Depository Institutions Deregulation and Monetary Control Act of 1980. That provision created an Interagency Task Force consisting of participants from several governmental agencies. Utilizing existing staff and resources, that Task Force was able to examine a highly complex issue and produce a comprehensive report on the problems facing thrift institutions within the three-month period provided by the Act.

We believe that by the use of existing resources, it is possible with maximum efficiency and with appropriate speed, to survey the area of usury and make specific recommendations.

It should be emphasized that the Interagency Task Force on Thrift Institutions included in its deliberations the question of the impact of state usury laws when considering the viability of expanded consumer credit activities by thrifts. In view of their preliminary research and analysis

in this area and what we believe to be the desirability of avoiding the creation of yet another governmental agency or commission, we would respectfully urge that the Committee consider utilizing the Interagency Task Force mechanism in analyzing this important problem. Given its history of performance and background, we would suggest that the Task Force participants be the same, except that there seems to be little utility in retaining the members of the Task Force who were available to focus directly on housing questions (those being the Department of Housing and Urban Development and representatives of the Office of Management and Budget involved with housing).

In effect, we would suggest that the study be undertaken by an Interagency Task Force consisting of the following members:

1. the Secretary of the Treasury;
2. the Chairman of the Federal Home Loan Bank Board;
3. the Chairman or the Vice Chairman of the Board of Governors of the Federal Reserve System;
4. the Chairman of the Federal Deposit Insurance Corporation;
5. the Comptroller of the Currency; and
6. the Chairman of the National Credit Union Administration Board.

If a task force is to institute a new examination of usury laws and related questions, we would urge that it include consideration of the costs of limiting creditor contract options and remedies. In this area, too, studies have been made that should be considered by Congress. For example, the task force should analyze the cost of limiting the "Rule of 78's" in connection with precomputed finance charge transactions. It would be our expectation that if some form of a review is to be undertaken, it would include an evaluation of the impact of S. 2002, now pending before this Committee and that the study would include recommendations with regard to a possible federal treatment of that common contract provision.

In light of the increasingly dynamic nature of the money marketplace and of the need for immediate attention, we would suggest that the task force should be mandated to report to the Congress not later than February 27, 1981. Given the activities already undertaken by the Interagency Task Force in the usury area and the speed with which it has proven itself able to react, we believe that this period of time will afford an opportunity for a careful review and analysis with the abundant information and materials that exist in this area.

III. CONCLUSION

Mr. Chairman, The Consumer Bankers Association is greatly appreciative of this opportunity to present its views. In summary, we would be pleased to support the Cash

Discount Act, if it is modified in two ways: first, the lifting of the 5% cash discount limitation must be tied to a permanent ban on credit card surcharges; and second, consumer protection provisions should be retained to prohibit the selective or discriminatory availability of cash discounts.

In addition, we believe we must oppose the creation of a Consumer Usury Study Commission. To establish another federal entity would be costly, inefficient and unnecessary given the substantial amount of study and analysis that has been done in the usury area. If non-Congressional consolidation of this information is deemed necessary, the Association recommends the utilization of the recently used interagency task force mechanism made up of participants from several existing federal government agencies.

Thank you, Mr. Chairman.

Mr. O'CONNOR. Mr. Chairman, I am Leonard F. O'Connor, vice president of the First National Bank of Boston, Boston, Mass. I serve as chairman of the government relations committee and am a member of the executive committee of the Consumer Bankers Association. The Consumer Bankers Association greatly appreciates this opportunity to present testimony concerning H.R. 7340, the Cash Discount Act, and your proposal to introduce legislation establishing a Consumer Usury Study Commission.

The association generally supports the Cash Discount Act with two important qualifications. First, the association believes that the removal of the 5-percent cash discount limitation must be tied to a permanent ban on the use of credit card surcharges. Second, the association believes that consumer protection provisions must be inserted into the act to prohibit the selective or discriminatory availability of cash discounts.

Senator MITCHELL. Mr. O'Connor, let me interrupt and ask you why you feel that the two must be linked? Why must the cash discount, if it is as you say a good idea, be linked to anything else?

Mr. O'CONNOR. Well, we feel there's possible confusion in the pricing mechanism that the consumer will be faced with and possibly a multitude of prices and choices to be made. We do believe that disclosure requirements that are necessary. The surcharge issue in terms of credit cards seems to be discriminatory against other types of payment mechanisms, particularly with the evolving

payment mechanisms that we are looking at today, such as debit products and checks and overdrafts and the like.

Senator MITCHELL. You say it would be discriminatory against them by authorizing or permitting a surcharge or, in effect, what it would be doing is removing a Federal prohibition on surcharges?

Mr. O'CONNOR. Yes.

Senator MITCHELL. How would that be discriminatory against other forms of payment?

SURCHARGE DIFFERENT FROM DISCOUNT

Mr. O'CONNOR. Well, we feel that the surcharge is totally different from the discount. It revolves around a determination of the actual price. We agree with all of the available data that the mechanism of discounts has not become widespread to any great extent. We look at it as our credit card merchant, that the discount rate actually paid to the credit card bank or company is simply a matter of overhead. To the retailer it's similar to heat or staffing expense or floor space. It is not viewed as an identifiable part of the pricing mechanism. We think it unfair to credit card users to face a surcharge with the use of that card in terms the fact that of the regular price if that has been determined based on the inclusion of the discount as an overhead item.

Senator MITCHELL. I understand what you're saying, but how does that lead you to conclude, as you did just before that, that removing the prohibition against surcharges would be discriminatory against other forms of payment? Did I misunderstand you or did you say that?

Mr. O'CONNOR. Well, in our written testimony we do talk about the discriminatory aspects in terms of very often payment by check is less efficient and more expensive than payment by cash for both the consumer and the retail operation and financial intermediary. A check requires costs ultimately to be borne by the consumer either visibly or less visibly in terms of their own deposit account or overdraft credit line. The consumer who is using credit cards—in fact, the use of that card could be cheaper than the use of checks in terms of the convenience of payers who pay no charge to themselves.

Senator MITCHELL. But if we eliminate the Federal prohibition, all we do is leave that up to the individual merchant or retailer to make the decision for himself or herself, do we not?

Mr. O'CONNOR. Yes, sir.

Senator MITCHELL. Don't you think that American businessmen and women are capable of making their own judgments in this area?

Mr. O'CONNOR. Probably.

Senator MITCHELL. Why don't you proceed then?

Mr. O'CONNOR. Your letter inviting our participation in this hearing specifically invited our comments on the possible formation of a national commission to study State usury laws. The association has consistently taken the position that artificial governmental controls on the rates and fees charged in credit transactions reflect inefficient and outmoded concepts of consumer protection.

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Senator MITCHELL. Well, let me just stop you right there. The association—this is your sentence—

> has consistently taken the position that artificial governmental controls on the rates and fees charged in credit transactions reflect inefficient and outmoded concepts of consumer protection.

Is not the Federal prohibition against surcharges on credit cards precisely such an artificial governmental control?

Mr. SCHELLIE. If I may address that, Mr. Chairman, I believe that the kind of control we're talking about here is control that establishes artificial limitations or ceilings, if you will, on something that would otherwise be allowed to operate in the free market. The surcharge prohibition simply attempts to make sure that everybody plays by the same set of rules so the consumer will have an opportunity to make logical and reasonable cost comparisons as between prices and the cost of credit. There is a significant potential that if we establish either by mandate or by permitting the imposition of a permissive surcharge system on top of a Federal Government pricing structure, which we have now, we will produce at least three levels of pricing that we think will be confusing to consumers, will allow in many cases the hiding of finance charges in cash prices, and in effect would not be beneficial to the overall pattern of comparison pricing between cash purchases and the use of credit.

One pricing approach plainly disclosed and made available to consumers in order to allow them to make reasonable and meaningful comparisons, we think is preferable.

"GET THE GOVERNMENT OFF MY BACK"

Senator MITCHELL. But you see, here's the problem, Mr. Schellie. It has become almost as popular in this country to say "Get the Government off my back," as the use of the phrase, "You know." There isn't a public figure in this country who doesn't get up and say, "We ought to get the Government off the people's backs," and I don't know of a banker in my State who's not constantly telling me and other public officials—indeed, I don't know of a citizen in my State that doesn't agree with the abstract principle, "Get the Government off my back."

And Mr. O'Connor's written statement has repeated references to that. Now, however, here is a proposal that would do just that and what position is taken by your association? It is not "Get the Government off my back." It is "Because this is beneficial to me, I want continued government involvement, Federal Government involvement in this area."

So you get this situation where everybody agrees in the abstract with the popular slogan "Get the Federal Government off my back, get the Federal Government out of the field of business, unleash the wisdom and enterprise of the American businessman and woman," and yet, whenever any proposal—and believe me, I don't limit this to you—whenever any proposal is made, there's always somebody who says, "While I agree with the abstract principle and while I think we have got too much regulation in this industry, but wait a minute here, this one helps me."

So I'm thinking of calling for a national parenthetical statement that must follow the phrase, "Get the Government off my back," which will say, "except when it helps me."

Mr. SCHELLIE. Mr. Chairman, may I respond?

Senator MITCHELL. I wish you would.

Mr. SCHELLIE. I certainly agree with all you say and I certainly agree that at least from our association's point of view we would agree that surcharges ought to be left up to individuals to impose or not impose as they see fit, if there were a decision to reverse what has been about a 12-year process at the Federal level to channel decisionmaking into specific modes so as to provide consumer protection and comparable credit information to consumers.

The issue we're addressing is one being addressed because in 1968 the U.S. Congress adopted the Truth in Lending Act that reflected a Federal decision to force creditors to treat certain items in certain ways so that consumers can make informed decisions. This is the process that has forced us to address this issue today.

If the suggestion of the chairman is that we do away with truth in lending and its channeling of private sector products into artificial categories so the consumer can understand credit costs, then we would agree.

If, however, the approach is going to be we are going to make you do certain things in order to inform the consumer and to regulate the industry, then we would say we should do it in a way which will, in fact, be not only meaningful to the consumers but will be understandable to the members of the industry as well.

So "Get the Government off our back," we would agree; but we don't believe that the continuation of a surcharge which is simply one aspect of a Federal program that forces us into this mode is duplicitous with that statement.

Senator MITCHELL. I understand your argument, Mr. Schellie. The problem with that is that if you adopt the position that there will be no deregulation until there is all deregulation, there will never be any deregulation, and I'm sure you understand that as a practical matter. And if everybody takes that position, then all forms of Federal regulation will be frozen in place. There could not possibly occur any deregulation and the only direction in which future events could take us would be toward increased federal regulation because, of course, there's always constant pressure for that.

Mr. SCHELLIE. We would respectfully submit that while that certainly strikes me as being a possibility——

Senator MITCHELL. You know as a practical matter that the Truth in Lending Act is not going to be repealed, no matter what you say or do.

Mr. SCHELLIE. Mr. Chairman, people keep telling me that. I'm led to believe that's the case.

Senator MITCHELL. I have only been here 7 weeks, Mr. Schellie, so I'm perfectly willing to listen to a contrary view if you think it's possible.

Mr. SCHELLIE. I guess the point we would make, sir, is that we believe the relationship, the nexus, between surcharges and the question of pricing credit products is sufficiently tied to truth in lending that we really aren't making a cataclysmic argument that

"if you deregulate this you've got to deregulate the world." We're saying that the overall Truth in Lending question is an integral part of the surcharge issue and if we are going to have to live within it with various types of charges and fees and finance charges, we ought to do so in a meaningful way that would permit comparable credit shopping, not hidden credit charges that will cause confusion on the part of consumers and on the part of the credit industry.

Senator MITCHELL. Thank you, Mr. Schellie.

Mr. Fox, we don't want to leave you out of this. Any time you want to jump in, go right ahead.

Mr. Fox. Of course, the ABA recommends that the current prohibition against surcharges be made permanent. Personally, I have a more practical approach to the problem. I'm not sure I understand half of what I've heard as far as some of the legal matters are concerned. From a practical standpoint, there are many problems connected with the surcharge. For example, I have in my pocket a card that looks like a credit card accesses my checking account. I'm not sure that any merchant could identify that as either a credit or a debit card and thereby determine whether to apply a surcharge or not.

In addition, the smaller merchant would be in competition with the larger merchants who have their own credit plans. I don't believe the larger merchants would put a surcharge on their own card, but they may put one on a bank card or an American Express card. I think that would be unfair and I think that that would certainly create an environment that we don't want.

FREE ENTERPRISE SYSTEM

Senator MITCHELL. Don't you believe in the free enterprise system?

Mr. Fox. Yes.

Senator MITCHELL. Isn't that free enterprise?

Mr. Fox. Not exactly, I think that it's unfair to the customer who, rather than having 50 cards or accounts, wants 1 because he cannot get from certain cards the services that I can offer him on my card but then on that 1 card he wants he's got to pay a surcharge. I think that is just unfair to burden the consumer with the surcharge.

Surcharges, if I understand the issue correctly, are predicated on the idea that the merchant in some fashion has huge expenses associated with the bank card. Well, that is, in my judgment, absolutely not true.

Senator MITCHELL. You mean that they are not huge or that there aren't any expenses?

Mr. Fox. No, sir. Our average merchant discount is only 1.78 percent.

Senator MITCHELL. Let's assume 1.78 percent. Why should the cash customer subsidize that?

Mr. Fox. I understant your concern. I also understand that there are other merchandising practices which costs far exceed the merchant's cost of accepting a credit card. The prepackaging of goods is not inexpensive. Some stores have child centers. There are many different services that are offered by merchants. There are certain

stores that have large floor space for exclusive services. The expense for that floor space is subsidized by the floor spaces that sell the majority of the run-of-the-mill goods—the shirts, socks, et cetera. The exclusive service, a bridal shop for example, is used to attract customers to the store. There's all kinds of unfairness in allocation of the cost of consumer conveniences. I don't know how to get at the issue. Certainly, I think the competition is going to rule. Do you see how I feel?

Senator MITCHELL. I see how you feel, but you just said competition should rule and if you permit people to engage in free enterpise activities that would dictate the result.

Mr. FOX. But do you want to ——

Senator MITCHELL. We don't have a Federal regulation that if you have a child care center in the department store that you have to allocate the cost to anybody. The store can have it or not, and then build the cost in if they want.

Mr. FOX. Right, but if we get a surcharge, whether it will be accepted by the merchants, whether they will add it, I'm not sure.

Senator MITCHELL. That's up to them.

Mr. FOX. That's up to them and we all have our ideas on that, but I really believe sincerely that by law you will be saying the bank cards are different from a store's own card and that, in some fachion, the cards are contributing more to the cost of merchandise. Yet bank cards, as expensive as they are, and we have experienced great increases in the cost of money in the last 2 years—are still cheaper than in-house credit plans.

Now I'm basing that strictly on figures from a national association for merchants.

Senator MITCHELL. You think there are no losses to the merchant?

Mr. FOX. No, they have the same problems we do or similar problems, except they sell merchandise and we lend money. That's the difference, and there's the motivation. They have a markup on merchandise that banks don't have.

Senator MITCHELL. OK.

Mr. FOX. You have thoroughly scared me to death.

Senator MITCHELL. Don't feel that way, Mr. Fox.

Mr. FOX. I won't. I've given you an honest opinion.

Senator MITCHELL. That's all I ask of you. You give me an honest opinion and don't worry about it. You would have been scared of me 2 months ago when I was a judge and had a robe on. Just say what you want and say what's on your mind.

Go ahead, Mr. O'Connor.

Mr. O'CONNOR. Senator, I'd just like to make one point that's always troubled me about discounts—not so much discounts, but the area of surcharges. That's been basically that there is—if we can get back to free enterprise, I'm in favor of free enterprise. There's never been a correlation between the surcharge that a retailer could charge to a consumer using a credit vehicle and any cost relationships. An example of a merchant who pays a 2-percent discount rate to the credit card company, a charge of 5 percent to the consumer or 10 percent or whatever the number is, certainly seems unfair to that credit card consumer.

I think the consumers generally understand the concept of the discount for paying cash. It is not widespread but there are instances where retailers or merchants have done that and I think that's an understood concept.

I guess the troubling part of your surcharges is exactly that there's no relationship to the cost associated with using that card to the surcharge and it could get passed along to the consumer.

Senator MITCHELL. Why don't you continue with your statement on the proposed Usury Commission, Mr. O'Connor?

Mr. O'CONNOR. I'll pick up where I left off I believe.

STUDIES REVEAL DEFICIENCIES

Extensive studies undertaken over the last two decades reveal the deficiencies in the arguments originally advanced in support of usury limits. We believe that these analyses provide a very substantial information base from which legislation could be formulated. We are simply unable to identify the need for extensive reevaluation that merely duplicates information and reports that are currently available. If an attempt is to be made to compile this data, existing agencies using their staff and other substantial resources and expertise should be utilized. The association respectfully submits that a new entity—with its incumbent delays and expense—is simply not called for in these circumstances.

Mr. Chairman, usury laws were adopted in response to moral and religious attitudes that reflected a noncommercial, noncredit society in which lending was an extraordinary rather than a typical event. Since that time, lending of all types—including consumer lending—has been converted from an activity limited in both scope and constituency to one of importance to virtually all consumers.

Despite some claims to the contrary, the Federal Government has long been involved in consumer credit cost questions. In 1933, for instance, Congress established a permissive maximum interest rate ceiling for national banks, thereby preempting State usury laws that were below that level. That concern was also reflected earlier this year when Congress adopted legislation containing provisions overriding some State usury laws. A continued congressional role is suggested in issues directly affecting the cost of credit. For instance, S. 2002, now pending before this committee, would restrict severely the availability of the "rule of 78's" rebate method, thus reducing income to creditors who often are unable to recoup their losses due to usury ceilings.

When usury statutes were enacted, they reflected pending economic conditions—including the market rates, absolute money cost factors and other costs. These factors simply cannot be reflected through any form of fixed price controls, including those on interest rates. If reasonable availability of credit is to continue, basic changes in the society must be recognized in the area of consumer credit and long held, but arguably obsolete attitudes and justifications must be rejected.

Over the past two decades, usury, its underlying rationale and its effects have been the subject of extensive examination and study. Some of the areas studied are listed in our written testimony, but suffice it to say that the subject matter has been surveyed, studied,

analyzed, monitored, examined, and reviewed from virtually all angles.

Those supporting usury laws seem to rely upon various economic arguments that this recent period of extensive study has refuted. In this series of reports, surveys, and studies, researchers have identified and shown a number of negative impacts produced by usury laws. Usury restrictions limit the availability of credit. In addition, evidence has shown that in States where the free market rate is above the ceiling, the poor, the transient, the young, and those with large families are rationed out of the credit market first, since financial institutions must utilize nonprice methods to decrease risk and increase effective yields.

These studies have also extended to specific analyses of the economic impact of static rate ceilings in an industry characterized by dynamic changes in costs. One study of bank credit cards conducted in my State of Massachusetts by the highly respected firm of Peat, Marwick, Mitchel & Co., revealed that the banks surveyed lost $13.84 on each credit card account. On a transaction basis, each time a consumer used his or her bank credit card, the bank lost 81 cents. The cost calculations reflected in that study indicate that, in order for a bank to break even, its cost of funds would have to be 6.68 percent—a cost of funds level that has not been available for some time.

The study of usury has also been carried out by governmental agencies. In 1968, Congress established a nine-member National Commission on Consumer Finance. Four years later, the National Commission filed its final report that included extensive analysis and recommendations regarding usury. In its summary recommendations, the Commission advocated raising or eliminating interest ceilings after procompetitive measures were undertaken. The conclusions reached are no less valid in July 1980 than they were in December 1972.

Senator MITCHELL. Just a minute, Mr. O'Connor. You heard Governor Teeters and both Mr. Jestrab and Mr. Malarkey testify that there has been a dramatic increase in open-end credit in the decade of the 1970's. Do you agree with that?

Mr. O'CONNOR. Yes, sir.

Senator MITCHELL. Do you agree with that, Mr. Schellie?

Mr. SCHELLIE. Yes, sir.

Senator MITCHELL. Do you agree with that, Mr. Fox?

Mr. FOX. Yes, sir; there has been an increase, but the economy has expanded, but there's been a further movement from other types of credit into bank credit card as an example, and it's a mixed bag. You can't say that this exploded and this is a total credit that never existed before. The greater portion existed.

Senator MITCHELL. I understand that. My point is that is it fair to say that when that study was completed in 1971 and 1972 it could not obviously have taken into account those events which occurred in subsequent years?

Mr. O'CONNOR. Senator, the National Commission on Consumer Finance, in terms of their efforts, the first three items to be addressed by the proposed Commission are basically restatements of the National Commission's charge at that time.

Senator MITCHELL. Precisely, taking into account that there have been significant changes since then.

Mr. O'CONNOR. Right. We think from our comparison of those first three charges that the issues have not changed considerably.

Senator MITCHELL. Well, all right. Go ahead.

Mr. O'CONNOR. Since that major effort, Congress has created another fact-gathering mechanism and has received its report only a month and a half ago. The Interagency Task Force on Thrift Institutions recommended in its June 30, 1980, report that Congress give serious consideration to an override of State ceilings on interest rates charged on secured and unsecured cash loans, credit card transactions, overdraft loans and other, similar forms of consumer lending.

Senator MITCHELL. Do you support that proposal, Mr. O'Connor?

Mr. O'CONNOR. Yes, sir.

Senator MITCHELL. Do you support that, Mr. Fox?

Mr. FOX. Yes.

Senator MITCHELL. Do you, Mr. Schellie?

Mr. SCHELLIE. Yes, sir.

Senator MITCHELL. Isn't that more of the Federal regulation which you just told us earlier, all of you, that you don't think should exist? Again, getting the Government off my back, but here you want the Federal Government to override State statute in a whole range of areas where the States have traditionally acted. Do you believe in States rights?

Mr. FOX. I certainly do to an extent. I find it very hard to believe that all of a sudden I'm on the other side of the track. I'm a bank card banker, primarily. We deal with the northern Virginia market and many of my customers in the northern Virginia market move to other States with different legal rates and requirements. We have a choice to either bill them as that State dictates or to tell them goodby. I don't like to tell customers goodby. I'm not dealing with just a one-State market but a regional market, and that's one reason for our position.

Senator MITCHELL. So the general principle must bend in the face of economic reality?

Mr. FOX. Right. You'll get me on that later, but I mean that's the thing.

Senator MITCHELL. Don't get upset. I'm as new at this as you are.

Mr. FOX. I know, but you've got——

Mr. SCHELLIE. Mr. Chairman, may I make a comment? Again, I believe that the answer that we would suggest would be if there were not already Federal involvement in the area we would agree that perhaps there ought not to be Federal involvement at this time.

Senator MITCHELL. Well, there are State ceilings on interest rates charged on secured and unsecured cash loans. Is there now a Federal ceiling on such loans?

Mr. SCHELLIE. Yes, sir, there is. Since 1933 for national banks there's been permissive maximum rate allowed. That was extended to State chartered and federally insured institutions on March 31 of this year.

Senator MITCHELL. That already now applies to all banks?

Mr. SCHELLIE. That's correct.

Senator MITCHELL. What's the purpose of having new legislation?

Mr. SCHELLIE. All that does is establish an alternative maximum limit which in effect is tied to an administered rate, the Federal Reserve discount rate, which is established and changed for reasons that often have nothing to do with market rates.

But our point I think would be, Senator, that not only do we have already Federal involvement in questions of rate ceilings itself, but——

Senator MITCHELL. If you really believed in getting the Federal Government off your backs, you would be proposing that the present Federal involvement be repealed. Would you be satisfied with that? And leave the State usury ceilings in effect?

Mr. SCHELLIE. Yes, sir, along with the Truth in Lending Act, Fair Credit Reporting Act and——

Senator MITCHELL. No, no, no. You're getting back to the same question. Let's take this specific area which is in your statement, that override by the Federal Government of State ceilings on interest rates charged on secured and unsecured cash loans.

Now if the existing Federal regulations in that area were repealed and State usury statutes were left in place, would you be satisfied with that?

Mr. SCHELLIE. No, sir, because——

Senator MITCHELL. So you want more Federal regulation, not less?

FEDERAL GOVERNMENT CREATED PROBLEM

Mr. SCHELLIE. Because the costs that are directly related to the question of what it costs to make a loan today have been so tremendously influenced by an array of Federal statutes, 14 in number in the last decade. As the Conference of State Bank Supervisors' witness earlier said, what we have is largely a Federal Government created problem. We have the Federal Government adding significant costs through a number of programs, some visibly and some less visibly.

An example of one that's visible is presently pending before this committee in the form of S. 2002, in which a typical contract provision would be limited and be held down that clearly by testimony presented before this committee would involve reduction in credit or income.

Senator MITCHELL. You're against that form of Federal regulation, aren't you?

Mr. SCHELLIE. We are against that form if it does not take into account——

Senator MITCHELL. Isn't it true that that form of Federal regulation is adverse to the economic interests of the people you represent?

Mr. SCHELLIE. It is adverse only to——

Senator MITCHELL. Isn't it true also that the Federal regulation that you favor is not adverse but in fact is beneficial to the economic interests of the people you represent? There's nothing wrong with that. There's nothing wrong with being for Government involvement when it helps you and against it when it hurts you. Almost everybody in the country is for that. But I think we ought to be clear on what your position is.

Mr. SCHELLIE. I understand that, Mr. Chairman, but if I might respond, it seems to me the point is if there is a Federal intervention that increases costs but not a countervailing federal involvement to allow those costs to be recouped over a broader base, which presumably is the income redistribution function represented in S. 2002, then we have in effect a creation of costs or reduction in income by the Federal Government on the one hand, but no provision to allow the recoupment of those costs on the other hand. So you can impose limitations, restrictions and costs at the Federal level, but to fail to recognize that you're pushing the credit industry against the States' income ceiling simply doesn't I think deal equitably with the problem.

In addition, it seems to me important to point out that we have had for many, many years limitations at the Federal level on the amount of interest that we pay on deposit accounts in the form of the regulation Q authorization. As you know, that is being phased out so that, again, like it or not, we find ourselves with substantial Federal involvement and intervention in the cost of funds to be used in lending but at the same time no recognition of need to reflect these costs in rates now subject to State control. We would ask, remove us from limiting artificial ceilings that don't take these developments into account.

Senator MITCHELL. Well, I appreciate your testimony, Mr. Schellie, but it's rather clear to me that you're just representing your industry as best you can and doing a good job at it, and you're no different than all Americans. I get thousands of messages every week. Everybody wants spending increases in defense, spending increases in domestic programs that benefit themselves, plus balance the budget yesterday. Essentially, the position you take is that position. I don't blame you for that. That's simply one of the realities we're going to have to deal with.

Why don't you go ahead, Mr. O'Connor?

Mr. O'CONNOR. In addition, the task force found that usury ceilings have a number of undesirable economic effects.

These are only a few of the studies, reports, surveys and analyses that have already been undertaken in this area. The field is virtually cluttered with data and materials dealing with the disclosure and adverse effects of usury laws. Additional study and analysis at this point would truly be—to use an overworked phrase—reinventing the wheel.

The association believes that Congress should move to release credit costs from state price controls. Existing materials introduced through the traditional congressional hearing process would provide more than adequate information for legislative deliberation and action. A commission is simply not needed.

Senator MITCHELL. Can I anticipate that when I said in my opening statement that I expected that there would be requests made for the 97th Congress to have further Federal override of State ceilings and interest rates, you probably will be recommending and supporting such legislation?

Mr. O'CONNOR. Yes, sir.

Senator MITCHELL. I expect the American Bankers Association will be doing the same thing?

Mr. Fox. Yes, sir.

Senator MITCHELL. So all the areas that the interagency task force covered that you referred to in your statement, Mr. O'Connor, you're going to be back next year asking for the Federal Government to override State usury statutes in all of these areas?

Mr. O'CONNOR. Yes, sir.

Senator MITCHELL. My expectation will be correct?

Mr. O'CONNOR. Yes.

Senator MITCHELL. All right. Go ahead.

OPPOSE CREATION OF NEW ENTITY

Mr. O'CONNOR. The association is opposed to the creation of a new Federal entity to study usury because more efficient and timely methods exist for assembling the information necessary for congressional action.

Existing governmental agencies and entities could more effectively and efficiently be used to accomplish the same result.

The creation of a new entity would involve substantial delay and expense, both of which could be avoided by utilizing existing information and resources. Purely mechanical questions of staff, office space, office equipment and the like will waste time that the time-critical usury issue can ill afford.

Moreover, the process of establishing a separate credit commission has proven to be unmanageable in the past. The National Commission on Consumer Finance, established in 1968, twice had to ask the Congress for additional time and once for additional funds. Even with these further extensions and appropriations, the Commission submitted its final report in 1972 long before the completion of several key studies—a process which disturbed more than one Commission member, including Senator Proxmire.

The shape and nature of government seem to make it inevitable that any new commission would encounter the same budgeting and time constraints. Together with probable changes in membership and staff, we fear that these forces would create a bureaucratic agency with a life and purpose of its own.

The association believes that the magnitude of the problem created by State usury laws suggests the need for expeditious congressional action. A prompt review of and response to the difficulties being faced by banks and other creditors seems inconsistent with the time frame that would necessarily be involved with the creation of a commission.

Senator MITCHELL. Would you be less opposed if the period of time for the study were shorter?

Mr. O'CONNOR. Yes, we would be less opposed, although we do have concerns about the composition of the proposed Study Commission. We still feel there is a basic organizational and management time frame that would have to be dealt with which may prohibit shortening that time frame by any great period of time just to get started.

Mr. FOX. May I address that, too?

Senator MITCHELL. Yes, Mr. Fox.

Mr. FOX. My concern is the need that presently exists—and I'm sure it's going to continue. Our expenses for the first half of 1980 increased 19 percent over the same period in 1979, but my cost of funds went up 74 percent. My increase in center expenses is totally

volume related. In comparing 1979 with 1978 my center expenses went up 13 percent, but my cost of funds went up 82 percent. The cost of funds is a real burden and a bothersome problem for even the most efficient centers. It is difficult to operate in this type of environment and get the return that our stockholders demand of us.

COMPETITIVE RATES

Senator MITCHELL. Is there competition now?

Mr. FOX. Yes, sir.

Senator MITCHELL. In open-end credit?

Mr. FOX. Yes, sir, very much so.

Senator MITCHELL. In rates?

Mr. FOX. Yes, sir. I would hedge that somewhat, if I may give you some history. Because of the circumstances now, most finance charge rates have been pushed by banks—not all banks, but in most banks—to the rate ceiling. In Virginia from the early 1970's to 1979, one Virginia bank allowed a free 30 days billing on cash advances and then charged 18 percent, the maximum that the State statute allowed. In Virginia a creditor has two options. To charge 18 percent, you have to give a free 30 days billing. Alternatively, a bank can charge 12 percent on cash advances with a one-time 2 percent charge on the front end. United Virginia had difficulties with the 2 percent. We eliminated this 2 percent on cash advances in 1971. We did that primarily because it created problems with the Truth in Lending Act, our disclosures, and our billing statement. We got rid of the 2-percent fee.

As a result, our cash advances exceeded our expectations. We were competing at that time with another major State bank who had statewide ATM's and were advertising all over the State for cash advances. We beat the socks off them.

Now we have continued to try to be competitive in rates, but we are forced now to take advantage of whatever rate is available, but we have not gone to the front-end fee, but will soon be forced to.

Senator MITCHELL. Thank you, Mr. Fox.

Mr. O'CONNOR. Senator, I think there's ample evidence of competition, although we would agree that rates and revolving products, particularly bank cards, have been forced to the maximum ceiling in most States where ceilings exist. There are a couple that have no ceilings. One, our common neighbor, New Hampshire.

The competition that's been occurring, as Governor Teeters mentioned, is in terms of other types of more subtle and, we think, more confusing competitive aspects in terms of credit line offered, ease of availability, fees, calculation methods, free periods, and certainly not in terms of the desired effect of the Truth in Lending Act to allow consumers to shop where the rates are basically the same and there's evidence that consumers are aware of revolving credit APR's.

In a recent survey, 71 percent—in excess of 71 percent—of the consumers surveyed were aware of the APR on a credit card, a relatively high level, and there are a large number of competitors in the market. There are approximately 7,000 banks issuing credit cards. There's easy entry into the credit market itself and with the coming involvement of S. & L.'s in terms of consumer loan products. So we think competition is significant in the credit area.

Senator MITCHELL. Let me ask you this. Since there is now no effective rate competition because economic realities have forced you all to the maximum and you have all expressed concern for the consumers and we all talk about the need for competition, there's nothing prohibiting anybody from charging less than the maximum now, is there?

Mr. O'CONNOR. No, sir.

Senator MITCHELL. But nobody is charging less than the maximum as a practical matter?

Mr. O'CONNOR. Very few that I'm aware of.

Senator MITCHELL. All right. So if the ceiling is removed, while it is true that in the abstract competition will exist which doesn't now exist, the fact of the matter is that the only real effect will, of course, be to increase the rates charged. That's precisely why you want the ceilings removed, is it not?

Mr. O'CONNOR. Well, there's no doubt that there would be increases in those jurisdictions where there exist today unrealistic rate ceilings.

Senator MITCHELL. But isn't it true that most of the cards have been at the ceiling for years, even in past years when the cost of money was 75 to 80 percent less than it is today?

Mr. O'CONNOR. Yes.

Senator MITCHELL. So it isn't these newly created economic conditions that have produced the increase in the ceiling, is it? They have been at the ceiling for a long time. My point is that the only effect of removing the ceilings would be to increase the rates. That's the only reason why you want the ceilings removed?

Mr. O'CONNOR. In those States where the rates are unrealistically low. One has to look at California, which does not have a rate ceiling, yet those rates tend to follow the marketplace. They are controlled by competition and there's been a wide variation in those rates. I guess the effective cost has typically gone up. Some of the changes have occurred in 18 percent annual percentage rates instead of breaking some reduced rate at a certain dollar level that the dollar level has been increased. One banker has gone to transaction fees. Others have gone to annual membership fees. Certainly the California market is one of the most competitive in the country.

Senator MITCHELL. But the point is, Mr. Fox cites very persuasive fascinating figures indicating the difficulty he's having now because of current economic conditions, but the fact of the matter is, as you just indicated, the rates were at the ceilings long before the recent conditions he described.

Mr. O'CONNOR. Yes, sir.

Mr. SCHELLIE. Mr. Chairman, I think there's something to be said for that. In fact, they were. But the real problem is that at that time it was a profitable bank product admittedly and business should be able to make a profit and——

Senator MITCHELL. That's nothing to be ashamed of.

Mr. SCHELLIE. That's nothing to be ashamed of at all, but the fact is that the cost of the product, a widely sought after, widely accepted product, has simply gone up dramatically. The Peat, Marwick & Mitchel study showed that on each bank card account there was a

loss of $13.84 per year. Every time a credit card was used by a consumer, it cost the card issuer 81 cents.

While at one point the ceilings may have been too high for a relatively new product, new in the banking area over the last decade and a half, it's clear that that no longer is the case. Rates will go up because the product costs more and those who want the product ought to have the opportunity to pay it, but the rate should also reflect all of the charges as it does under the truth in lending concept that are assessed in connection with cards so you have rate comparability and you don't have the kind of potential for hiding charges which now must be done, for instance, by raising merchant discount rates which disguises the cost of credit rather than making it clear, providing a comparable disclosure, and then allowing consumers to make a decision whether it's worthwhile to purchase that product.

Senator MITCHELL. How high are the merchant discount rates now?

Mr. SCHELLIE. I think they vary and are negotiated between card companies. You'll have a panel later that will have a better answer than we.

Mr. O'CONNOR. I think the later panel will be able to address that probably better than maybe I could or Mr. Fox.

Mr. FOX. I could only give my own bank's.

Senator MITCHELL. What's yours, Mr. Fox?

Mr. FOX. Our average merchant discount rate is 1.78 percent.

Senator MITCHELL. Is it correct that Citibank recently increased its merchant discount rate to as high as 8 percent?

Mr. FOX. There are two kinds of income associated with the bank card. There's merchant income that should support the merchant expenses; and customer income. Many bank card processors are more efficient than others, but all have to support expensive processing and authorization systems not just in one city but statewide or nationally and in many cases internationally. You try to support the merchant side through merchant fees.

So to compete and be profitable, you've got to take both sides of the balance sheet and look at it, and that's what we try to do—the customer side and the merchant side—and they are both competitive and, yes, we have reached maximum. I don't have any problem with defending that nor do I have any problem with defending Virginia's 18-percent ceiling because, as I quoted you, even today I've got a problem with that, but you've got to look at the total as opposed to the individual service because that's the way the profit and loss comes out in the bank card operation.

CUSTOMERS UNAWARE OF DISCOUNT RIGHTS

Senator MITCHELL. Let me ask you both. A few years ago when this first came up an American Banker article indicated that bank credit card spokesmen objected strenuously to the surcharge because they saw the difference between that and a cash discount was that cash paying customers are probably too ignorant of their discount rights to use them but that the merchants, well aware of the financing charges they were paying and passing along, would be quick to attach a surcharge to credit cards.

Do you think that's an accurate statement today, Mr. O'Connor?

Mr. O'CONNOR. I really wouldn't feel free to comment. I'm not familiar with that statement until you just read it.

Senator MITCHELL. Well, you are now. I don't want to put you on the spot. If you prefer not to comment, you're free to say so.

Mr. O'CONNOR. I would prefer not to comment.

Senator MITCHELL. Do you agree, Mr. Schellie?

Mr. SCHELLIE. I would have to hear it again.

Senator MITCHELL. The 1975 American Banker reporting on this same issue, not a new issue, wrote that bank credit card spokesmen objected more strenuously to a surcharge than to a cash discount. They said that the difference was—these are bank credit card spokesmen—the difference between the two proposals was that cash paying customers are too ignorant of their discount rates to use them, but that merchants, well aware of the financing charges they are paying and passing along to their customers, would be quick to attach surcharges to credit cards, the effect of which would be to cut deeply into the use of cards. Do you agree with those statements today?

Mr. SCHELLIE. I think that result might obtain. I don't believe the pejorative reference to the relevant intellect of the cash user is correct. Indeed, my impression is that many cash users are brighter than anybody else because they avoid the problems we're talking about this morning. There is a lack of awareness as to the relationship between a card issuer and a merchant. I think that there are not a large number of consumers who know what the contract or discount rate relationship is between the drugstore and the credit card issuer. I would agree with that, but I'm not sure that I would not agree with that characterization of those cash users. But I think the conclusion is possible. I think it might well cut back the use of credit card as a convenience payment device.

Senator MITCHELL. Why don't you go to your conclusion, Mr. O'Connor.

Mr. O'CONNOR. In summary, we would be pleased to support the Cash Discount Act if it is modified in two ways: first, the lifting of the 5 percent cash discount limitation must be tied to a permanent ban on credit card surcharges; and second, consumer protection provisions should be retained to prohibit the selective or discriminatory availability of cash discounts.

In addition, we believe we must oppose the creation of a Consumer Usury Study Commission. To establish another Federal entity would be costly, inefficient and unnecessary, given the substantial amount of study and analysis that has been done in the usury area. If noncongressional consolidation of this information is deemed necessary, the association recommends the utilization of the recently used interagency task force mechanism made up of participants from several existing Federal Government agencies.

Thank you, Mr. Chairman.

Senator MITCHELL. Thank you, Mr. O'Connor.

Mr. Fox, you have already answered some of my questions but you cover some of the points in your statement. Could you summarize the principal points in your statement that you would like to make?

Mr. Fox. Yes, sir.

Senator MITCHELL. And we'll put the whole statement in the record.

STATEMENT OF JACK G. FOX, SENIOR VICE PRESIDENT, UNITED VIRGINIA BANKSHARES, INC., RICHMOND, VA., REPRESENTING THE AMERICAN BANKERS ASSOCIATION

Mr. Fox. Thank you, Senator.

Mr. Chairman, my name is Jack G. Fox and I'm senior vice president of the United Virginia Bankshares, Inc.

Senator MITCHELL. Excuse me, Mr. Fox. I was so interested in what Mr. O'Connor was saying that I didn't hear the bell ring and I have to go vote again. Probably I was more interested in what I was saying, if the truth be known, in not hearing the bell. But I'm going to have to go vote. Why don't you take this occasion, Mr. Fox, to look your statement over and be prepared to summarize it when I come back.

[Recess.]

Mr. Fox. I am prepared to summarize it.

Senator MITCHELL. Fine.

Mr. Fox. Mr Chairman, my name is Jack G. Fox and I am senior vice president of United Virginia Bankshares, Inc., in Richmond, Va. I am also a past member of the executive committee of the Bank Card Division of the American Bankers Association. The association's membership consists of more than 90 percent of the Nation's full service banks, including more than 12,000 community banks with deposits of $100 million or less.

I am here to testify on behalf of the association on two issues identified in your July 18 letter of invitation. First we will review briefly our previously stated views on H.R. 7340—the Cash Discount Act—and also address the related issue of surcharges. Second, we will discuss the proposal for legislation to establish a Consumer Usury Study Commission.

H.R. 7340: CASH DISCOUNT ACT

The association has no objections to the intent of H.R. 7340 to allow an unlimited cash discount as long as it can be implemented in a fair and nondiscriminatory manner.

In order for this legislation to be implemented in a fair and nondiscriminatory manner several conditions must be met. First, the availability of a cash discount must be made known to all prospective purchasers and the discount must be equally available to all prospective purchasers. Second, fair disclosures in advertising and telephone communications must be provided for. Without adequate consideration of these two issues, cash discounts could be applied in a discriminatory manner.

We would suggest that these problems may best be resolved by allowing the Federal Reserve Board to continue to write regulations on this issue. Presently section 3 of the bill would prohibit such regulations. Congressman Annunzio included this provision in the bill because of his concern that the strict disclosure requirements regarding cash discounts imposed by the Board discouraged merchants from offering the discount.

The Federal Reserve Board has recognized Mr. Annunzio's concern about the difficult disclosure requirements and has acted to remedy the problem. We would direct the committee's attention to

attachment A to our testimony. This attachment sets forth the regulations recently proposed by the Federal Reserve Board in its revision of regulation Z. With only minor changes, which we will be suggesting in our comments to the Board, this regulation represents a fair resolution to the concerns expressed by Congressman Annunzio, as well as our concern over possible discrimination in the manner in which the discount is offered.

Accordingly, the association urges that the subcommittee amend H.R. 7340 to insure that cash discount, when offered, are available to all prospective purchasers on a nondiscriminatory basis. We would suggest that the best method to accomplish this is to allow continued rulemaking authority to the Federal Reserve Board. This would allow the Board to issue the currently proposed regulations and to deal with any future problems that may arise.

CREDIT SURCHARGES

We believe that H.R. 7340 should be coupled with a permanent prohibition against credit surcharges. The current prohibition expires on February 27, 1981.

Initially, a concurrent system of credit surcharges and cash discounts will frustrate the purpose of truth in lending to enhance consumers' informed use of credit. If H.R. 7340 stimulates the use of cash discounts, as it is intended, and, at the same time, some merchants institute a credit surcharge, consumers will have extreme difficulty in understanding the true cost of using credit. In addition, they would experience more difficulty in comparing prices without taking the time to calculate the value of a discount on one price, or a surchange on another.

Second, a credit surcharge will have an adverse impact on card issuers and small merchants. A card issuer spends substantial time and money in developing a good image for its product. The surcharge, imposed by a merchant, makes a negative statement about the card to a consumer. The card issuers ability to create a favorable image for its products will be directly burdened by that negative image.

The small merchant would also be harmed. The small merchant's ability to compete with the large retailer is enhanced by the use of a card system. The merchant is able to increase sales volume and avoid the cost of expensive in-house credit programs, resulting in lower prices to his customers. The merchant is able to offer a convenient method of payment and limit the handling of large amounts of cash. The credit surcharge creates a negative image of a card transaction and could damage the ability of merchants who rely on card sales to compete effectively.

In summary, we view the credit surcharge as having an extremely negative effect on the card industry, and the competitive health of small merchants. The potential confusion for consumers as to the true cost of credit or goods plus the potential damage to the small merchant's ability to compete with large retailers makes a continuation of the current prohibition against surcharges imperative. We urge this subcommittee to give this careful consideration by adding such a provision to H.R. 7340.

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CONSUMER USURY STUDY COMMISSION

The chairman has indicated his intent to introduce legislation to establish a Consumer Usury Study Commission. The Study Commission would be composed of 15 members—including 1 banker—and would focus on 7 areas related to interest rates. The major area of concentration, however, appears to be the question of further Federal preemption of State consumer credit usury ceilings. The proposal calls for a 1-year study with the Commission's report submitted to the President and the Congress by December 31, 1981.

The association opposes this proposal for two reasons. First, pressing needs for relief, particularly in the area of open-end credit, have been amply demonstrated. Second, the issues which are proposed for study have already been adequately explored by academic, government and creditor groups. The Study Commission could shed little if any further light on these issues.

The Commission would only have the effect of postponing action that is needed now. Even State legislatures contemplating relief may hold their efforts in abeyance pending the results of the study.

PRESSING NEEDS IN OPEN-END CREDIT

VISA, U.S.A., Inc., has circulated figures showing that the credit card industry had a loss equal to 1.1 percent of average outstandings in the second half of 1979. During the period of high interest rates in the early part of this year a loss of over $865 million was projected for 1980. While this projection may have to be revised due to the drop in interest rates, a substantial loss is still expected.

A recent study by the Massachusetts Bankers Association demonstrated the unprofitable status of bank card operations of seven banks in that State. The study covered 1979—a period prior to the period of escalating cost of funds in early 1980. That study showed that the cost of funds would have to dip to 6.68 percent for card operations to become profitable unless usury laws or laws prohibiting credit card fees were changed. In Massachusetts, banks can charge only 12 percent on credit balances over $500 and 18 percent on balances under $500. No annual or membership fees are authorized.

Approximately 35 percent of cardholders involved in the study who used their cards paid off the balance within 30 days without paying finance charges. As a result, less than one-half—43 percent—of all cardholders paid the total finance charge. The study also showed that inflationary costs of labor, supplies and services plus the creditors' inability to increase finance charges and merchant discounts contributed to unprofitability.

The study concluded that, unless the law was changed to allow imposition of fees, the only means of avoiding unprofitable operations was to eliminate unprofitable accounts, that is, free users, or withdraw from credit card operations. Imposition of fees would allow the card issuer to realize some return on the unprofitable accounts.

Experience in individual banks is similar. Figures for one large New York bank (recently reported in the American Banker) indicated that the costs of funds would have to drop to 6 percent before a decent pretax profit of 2 percent could be achieved on bank card

operations. Gross yield on receivables for the bank equals approximately 17.5 percent with total expenses around 9.7 percent broken down as follows: 2.2 percent credit losses; 2.8 percent merchant expenses; 2 percent collection expenses; 0.7 percent overhead; and 2 percent other operating and servicing expenses. Thus a cost of funds of approximately 8 percent would be needed just to break even. In New York, banks can charge 18 percent on the first $500 in outstanding credit balances and only 12 percent on outstanding balances over $500. No fees are allowed.

NEED FOR FURTHER STUDY

We doubt that the establishment of a study commission would add substance to the already massive volumes of information relating to usury problems. The negative effects of State usury ceilings are well documents. The correlation between restrictive rates of interest and the negative impact on credit availability has been established. There can be no question that interest rate competition has operated to keep interest rates at reasonable levels in States where usury ceilings have been removed.

Action to remove interest rate ceilings must come at the Federal level, since the primary factors influencing the supply and cost of funds are determined at this level. Recent Federal legislation phasing out the Interest Rate Control Act (Regulations Q) will increase the cost of funds on deposit to financial institutions. Costs incurred by banks in borrowing or purchasing the funds they lend to consumers are largely a function of national economic events and policies. They are not determined at the State level. It is inequitable for the cost of funds to be determined on a national level while leaving decisions regarding interest rate ceilings on cedit extensions to State governments. The costs and price of funds are directly related, and government should recognize the relationship.

It is unrealistic to assume, in today's financial environment, that decisions concerning maximum permissible interest rates are local in nature and should be determined on a State by State basis.

A national commission concluded as early as 1972 that rate ceilings were undesirable. The report of the National Commission on Consumer Finance submitted in December of 1972 dispelled all popular theories on the need for rate ceilings. More recently, the report of the interagency task force on thrift institutions, submitted in July of this year, concluded that removal of rate ceilings was necessary to give thrifts incentive to enter into consumer lending.

We would draw the committee's attention to attachment B of our testimony which sets out the wealth of authoritative information and research on this subject.

The issues proposed for study have already been resolved by Congress in several situations. Public Law 96–221 enacted this year removed rate ceilings on mortgage loans and mobile home loans. Clearly, Congress determined that rate ceilings were not needed, that there was a direct correlation between usury ceilings and the availability of credit, that interest rate competition would be enhanced, and that there was no alternative to Federal preemption.

In summary, the need for a study comission has not been demonstrated. The only work that remains is to fashion proper legislation based on the extensive study that has already been done.

We appreciate this opportunity to express our views on these issues.

[Attachments to statement follow:]

ATTACHMENT A

Federal Reserve Board's Proposed Regulation Z
May 5, 1980
45 F.R. 29736
§226.4(f)

Discounts. A discount for the purpose of inducing payment for a purchase by cash, check, or similar means rather than by use of an open-end credit card account (whether or not a credit card is physically used) may be excluded from the finance charge 13/ if the following three conditions are met:

(1) The discount does not exceed 5 percent 14/ of the regular price 15/ of the property or service.

(2) The discount is available to all prospective purchasers, whether or not they are cardholders, and this fact is clearly and conspicuously disclosed in the seller's place of business. 16/

3) If an advertisement or telephone communication by which the creditor invites or accepts purchase orders states that consumers are allowed to pay for property or services by use of a credit card or its underlying account, the availability of the discount shall be clearly and conspicuously stated either in the advertisment or communication or before the transaction has been completed by use of the credit card or its underlying account. If a price other than the regular price is disclosed in an advertisement or communication, the fact that that price is not available to credit card purchasers also shall be disclosed.

13/ A discount that is not a finance charge under this paragraph shall not be considered a finance charge or other charge for credit under any state law relating to usury, disclosure of information in connection with credit extensions, or charges permissible in connection with the extension or use of credit.

14/ If the discount is greater than 5 percent, the total amount of the discount shall be a finance charge.

15/ "Regular price" means (1) the tagged or posted price; or (2) the price charged for the property or service where payment is made by use of an open-end credit card account if either (i) no price is tagged or posted, or (ii) two prices are tagged or posted, one of which is charged where payment is made by use of an open-end credit card account and the other where payment is made by use of cash, check, or similar means. For the purpose of this definition, payment by check, draft, or similar instrument that may result in the debiting of a cardholder's open-end account shall not be considered payment made by use of that account.

16/ The availability of the discount may be limited on the basis of some other distinction such as certain types of property or services, certain outlets, or cash payments only, if the limitations are clearly and conspicuously disclosed.

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Senator MITCHELL. I will be back in just a few minutes. I'd like to keep going for as long as our stomachs hold out. We will be in recess for a brief time.

[Recess.]

Senator MITCHELL. I apologize for the delay, gentlemen. You'll be pleased to know that the spirit we're discussing here has extended to the Senate floor where we just approved legislation that started out as a Federal requirement in certain areas of mental health services in the country, and ended up as a Federal recommendation.

The abstract principle with which we all agree has at least to some extent gone into effect.

Mr. SCHELLIE. Is that S. 2002 on the floor? [Laughter.]

Senator MITCHELL. No, unfortunately. Mr. Fox, are you prepared to summarize your testimony?

Mr. Fox. Yes, sir.

Senator MITCHELL. Thank you.

Mr. Fox. Mr. Chairman, I'm Jack G. Fox, and I'm a senior vice president of Union Virginia Bank in Richmond. I'm also a past member of the executive committee of the Bank Card Division of the American Bankers Association. The association's membership consists of more than 90 percent of the Nation's full service banks, including more than 12,000 community banks with deposits of $100 million or less.

I'm here to testify on behalf of the association on two issues identified in your July 18 letter of invitation. First, we will briefly review our previously stated views on H.R. 7340, the Cash Discount Act, and also address the related issues of surcharges. Second, we will discuss the proposal for legislation to establish a consumer usury study commission.

The association urges that the subcommittee amend H.R. 7340 to insure that cash discounts when offered are available to all prospective purchasers on a nondiscriminatory basis. We would suggest that the best method to accomplish this is to allow continued rulemaking authority to the Federal Reserve Board. This would allow the Board to issue the currently proposed regulations and to deal with any future problems that may arise.

We believe that H.R. 7340 should be coupled with a permanent prohibition against credit surcharges. The current prohibition expires February 27, 1981. First, a concurrent system of credit surcharges and cash discounts will frustrate the purpose of trust in lending to enhance consumers in use of credit.

If H.R. 7340 stimulates the use of cash discounts as it's intended to do, and at the same time some merchants institute a credit surcharge, consumers will have extreme difficulty in understanding the true cost of using credit. In addition, they would experience important difficulty in comparing prices without taking the time to calculate the value of a discount on one price or surcharge on another.

Second, a credit surcharge will have an adverse impact on card issuers and small merchants. A card issuer spends substantial time and money in developing a good image for its product. The surcharge imposed by a merchant makes a negative statement about the card to a consumer. The card issuer's ability to create a favorable image for its product will be directly burdened by the negative image. The small merchant would also be harmed.

The small merchant's ability to compete with the larger retailer is enhanced by the use of a card system. The merchant is able to increase sales volume and avoid the cost of expensive in-house credit programs resulting in lower prices to his customers. The merchant is able to offer a convenient method of payment and limit the handling of a large amount of cash. The credit surcharge creates a negative image of a card transaction and could damage the ability of merchants who rely on card sales to compete effectively.

Senator MITCHELL. Mr. Fox, is there any reason to believe that small businessmen are so ignorant that they will employ surcharges to their detriment?

Mr. FOX. I don't think so, no, sir.

Senator MITCHELL. You don't think American businessmen and women are stupid, do you?

Mr. FOX. No, sir. They are very astute.

Senator MITCHELL. The fact that someone has authority to impose a surcharge does not necessarily lead to the conclusion that he or she would do so to his own or her own economic detriment, does it?

Mr. FOX. No. That's right.

In summary, we view the credit surcharge as having an extremely negative effect on the card industry and the competitive health of small merchants. The potential confusion for consumers as to the true cost of credit for goods plus the potential damage to the small merchant's ability to compete with large retailers makes a continuation of the current prohibition against surcharges impera-

tive. We urge the subcommittee to give this careful consideration by adding such a provision to H.R. 7340.

The chairman has indicated his intent to introduce legislation to establish a Consumer Usury Study Commission. The Study Commission would be composed of 15 members including 1 banker and would focus on 7 areas related to interest rates. The major areas of concentration, however, appear to be the question of future Federal preemption of State consumer credit usury ceilings.

The proposal calls for a 1-year study with the Commission's report submitted to the President and Congress by December 31, 1981.

The association respectfully opposes this proposal for two reasons. First, pressing needs for relief particularly in the area of open-ended credit have been amply demonstrated. Second, the issues which are proposed for study have already been adequately explored by academic, government, and creditor groups.

POSTPONING ACTION THAT IS NEEDED NOW

The Study Commission could shed little if any further light on these issues. The Commission would only have the effect of postponing action that is needed now. Every State legislature contemplating relief may hold their efforts in abeyance pending the result of the study.

Senator MITCHELL. When you say it would only have the effect of postponing action that is needed now, are you referring to further Federal action to override State usury laws we discussed earlier?

Mr. Fox. Yes, sir.

Senator MITCHELL. Doesn't it bother you, coming from Virginia, which really is the home of the doctrine of States rights, even before Jefferson, 100 years before we became a nation, that here you're now calling for more Federal legislation?

Mr. Fox. It bothers me, yes. But I'm also faced with economic realities. The economic reality is that this is a matter that the States can't control. They are controlling the rate the customers pay, but they can't control the rate we have to pay for the money we have to borrow.

Senator MITCHELL. But everybody—everybody—who wants more Federal legislation says it's the reality of the situation that requires it. There is always a reality. Your economic reality compels you to this conclusion in this case. The economic reality of a person unable to subsist on local welfare calls for Federal action in that area. The reality of children not receiving a sufficient education compels—I mean, we don't live in isolation.

Mr. Fox. Right. The world is changing. The law sometimes doesn't change as fast as the world—the economic environment changes.

Senator MITCHELL. In view of these changes, do you think the principle of States rights has any more viability?

Mr. Fox. Its fabric is so weakened that it's probably torn to shreads.

Senator MITCHELL. Do you think we should just forget it? Wherever a compelling economic reality exists, get the Federal Government in the area?

Mr. Fox. I would back away from answering that.

Senator MITCHELL. My gosh, here I'm a Democrat from Maine arguing with a good man from Virginia about who should be for States rights and Federal——

Mr. Fox. We're not arguing. We're discussing one issue. How can I be led to the bottom line most efficiently.

Senator MITCHELL. You're very candid, Mr. Fox, to tell us that's the one issue.

Mr. Fox. That's the truth, I believe.

Senator MITCHELL. That's what I want from you, right.

Mr. Fox. VISA, U.S.A., Inc., has circulated figures showing that the credit card industry has a loss equal to 1.1 percent of average outstandings in the second half of 1979. During the period of high interest rates in the early part of this year, a loss of over 865 million was projected for 1980. While this projection may have to be revised due to the dropping interest rates, a substantial loss is still expected. The figures I gave you, my own experience in the change of cost of money in relation to previous years, indicates that that is going to take place.

A recent study by the Massachusetts Bankers Association demonstrated the unprofitability status of bank card operations of seven banks in that State. The study covered 1979. A period prior to the period of escalating cost of funds in early 1970 and 1980. That study shows that the cost of funds would have to dip to 6.68 percent for card operations to become profitable unless usury laws or laws permitting credit card fees were changed.

The study concluded that unless the law was changed to allow imposition of fees or rates, the only means of avoiding unprofitable operations was to eliminate unprofitable accounts, or withdraw from the credit card operation. Imposition of fees would allow the card issuer to realize some return on the unprofitable accounts.

As a matter of interest and as an aside to this, the 6.68 percent for card operations in this study compares to a 10 percent figure in another study we've conducted in our State. I mention that only to point out my previous statement efficiencies and problems inherent in my area versus someone else's area affects the overall profitability of centers and impacts on cost.

Experience in individual banks is similar. Figures for one large New York bank recently reported in the American Banker indicated that the cost of funds would have to drop to 6 percent before a decent pretax profit of 2 percent could be achieved on bank card operations. Gross yields on receivables for the bank equals approximately 17.75 percent with total expenses around 9.7 percent.

These expenses are broken down as follows: 2.2 percent credit losses; 2.8 percent merchant expenses. Merchant expenses as opposed to average discount is unrelated. This includes the necessary support—I'm confident this figure is only the expenses associated to run the merchant program: 2 percent collection expenses, 0.7 percent overhead, and 2 percent other operating service and expenses. Cost of fund of approximately 8 percent would be needed just to break even.

In New York, banks can charge 18 percent on the first $500 in outstanding credit balances and 12 percent on outstanding balances over $900. No fees are allowed.

We doubt that the establishment of a study commission would add substance to the already massive volumes of information relating to the usury problems. The negative effect of State usury ceilings are well documented. The correlation between restrictive rates of interest and the negative impact on credit availability have been established. There can be no question that interest rate competition has operated to keep interest rates at reasonable levels in States where usury ceilings have been removed.

REMOVE INTEREST RATE CEILINGS

Action to remove interest rate ceilings must come at the Federal level since the primary factors influencing the supply and cost of funds are determined at this level. Recent Federal legislation phasing out the Interest Rate Control Act, regulation Q, will increase the cost of funds on deposit to financial institutions.

Costs incurred by banks in borrowing or purchasing the funds they lend to consumers are largely a function of national economic events and policies. They are not determined at the State level. It's inequitable for the cost of funds to be determined on a national level while leaving decisions regarding interest rate ceilings on credit extensions to State governments.

The cost and price of funds are directly related and Government should recognize the relationship. It's unrealistic to assume in today's financial environment that the decisions concerning maximum permissible interest rates are local in nature and should be determined on a State by State basis.

A national commission concluded as early as 1972 that rate ceilings were undesirable. The report of the National Commission on Consumer Finance submitted in December 1972, dispelled all popular theories on the need for rate ceilings.

More recently, the report of the Interagency Task Force on Thrift Institutions submitted in July of this year concluded that removal of rate ceilings was necessary to give thrifts incentive to enter into consumer lending.

We would draw the committee's attention to attachment B of their testimony, which sets out the wealth of authoritative information and research on this subject. The issues proposed for study have already been resolved by Congress in several situations. Public Law 96-221 enacted this year removed rate ceilings on mortgage loans and mobile home loans. Clearly Congress determined that rate ceilings weren't needed, that there was a direct correlation between usury ceilings and the availability of credit, that interest rate competition would be enhanced and that there was no alternative to Federal preemption.

Senator MITCHELL. The fact that Congress determined that doesn't make it right, does it?

Mr. FOX. Not always in the broad sense.

Senator MITCHELL. A lot of things Congress did you don't agree with, do you?

Mr. FOX. Very definitely.

In summary, the need for a study commission has not been demonstrated. The only work that remains is to fashion legislation based on extensive studies that have already been done.

We appreciate this opportunity to express our views on these issues and I personally am very grateful for your courtesy.

Senator MITCHELL. Thank you very much. Mr. O'Connor and Mr. Schellie, in view of the hour, I think we will recess. I don't know whether the next group of witnesses can talk on an empty stomach, but I can't listen on one.

The remaining witnesses can review their testimony during the lunch break with a view toward summarizing them. I will resolve not to take as much time as I have with the other witnesses, and perhaps we can get through in due course.

We will recess for lunch until 2 p.m. At that time we will hear from Ms. Alexander and Mr. Erwin. We will be in recess until 2 p.m.

[Whereupon, at 1:05 p.m., the hearing was recessed, to reconvene at 2 p.m., the same day.]

Senator MITCHELL. Good afternoon, ladies and gentlemen. We will resume the hearing with testimony from Barbara Alexander, superintendent, Bureau of Consumer Protection, State of Maine, and Robert Erwin, Bureau of Consumer Protection of the State of Maryland.

Since I know Ms. Alexander, I will assume you are Mr. Erwin?

STATEMENT OF BARBARA ALEXANDER, SUPERINTENDENT, MAINE BUREAU OF CONSUMER PROTECTION, AND ROBERT ERWIN, DIRECTOR, MARYLAND BUREAU OF CONSUMER PROTECTION

Ms. ALEXANDER. That is correct.

Senator MITCHELL. Why don't you proceed? We are happy to hear what you have to say.

Ms. ALEXANDER. Thank you very much for inviting me to testify before you today concerning H.R. 7340, the Cash Discount Act, and your proposal to establish a Consumer Usury Study Commission. I not only represent the State of Maine in my testimony, but I represent the American Conference of Uniform Consumer Credit Code States. That mouthful is an organization composed of the 11 States that have adopted a version of the Uniform Consumer Credit Code. It includes Indiana, Oklahoma, Wyoming, Kansas, Wisconsin, Maine, Colorado, Iowa, and Idaho.

The UCCC is a comprehensive statute that regulates consumer credit addressing itself to licensing, the interest structure, and consumer protections and creditor remedies.

I bring this up because the statute recognizes an important fact. That is, that there is an intimate connection between two very important policy decisions in regulating consumer credit. That is, the establishment of maximum interest rates and the protections afforded the consumer in the content and enforcement of the consumer credit contract.

The UCCC also adopts the Truth in Lending Act and three of our States are exempt States for Truth in Lending.

I will very briefly make some remarks concerning the debate surrounding the discount and surcharge embodied in H.R. 7340. I do not think I can add too much to the debate you have already heard and will hear from other witnesses that will come after me this afternoon.

In preparation for any questions you might ask me on this point, I would make it clear that I am in favor of Federal regulation when it helps me and opposed to it when it hurts me. [Laughter.]

Basically, the conference has supported the Cash Discount Act if the availability of the discount is disclosed to all customers, not merely one segment of the merchants' business. The problem with the surcharge may be merely a conceptual one. However, it is one that will have to be confronted by the committee.

The surcharge on the face of it conflicts with the basic policy of the Truth in Lending Act. That is, that the consumer knows the full cost of credit. The surcharge is, because of the way it is structured, an increase in the cost of credit to a consumer. A cost that should be disclosed prior to the use of that credit. I admit it may be a distinction without an economic difference, but it does fly in the face of the very basic policy of the Truth in Lending Act.

I am interested in the fact that while the bank opposed surcharges, the credit card people support transaction charges, a distinction that also does not have much difference except that the earnings from a transaction charge accrue to the bank or the credit card people and the surcharge earnings accrues to the merchant. I would like to spend most of my time talking about the Consumer Usury Study Commission. We believe it is well considered and timely.

You have the full support of Maine and the Uniform Credit Code Administration with this proposal. The conference has adopted a resolution at our latest meeting in May which urges the halt to further preempt State laws so as to allow the States an opportunity to study and enact reforms which we know must occur at the State level.

CONSUMER STUDY COMMISSION NEEDED

I would like to first review why we believe the Consumer Study Commission is needed. Most of my remarks will be focused on the impact recent preemptions had in the State of Maine. Congress has undertaken a number of new initiatives in the last year to preempt or substantially impact State consumer credit law.

As you know, Public Law 96-221 preempts the rate for first lien mortgages on both real property and on residential manufactured homes. The Maine Code regulates mobile home credit sales and loans and we had 2 days before the Federal preemption took effect and enacted a bill in the State of Maine to raise rates for mobile home credit sales and loans from 13 to 18 percent, thus responding to the economic situation that demanded it.

The Federal preemption made our activity a nullity. In addition, I would like to point out that the act requires regulations now promulgated by the Federal Home Loan Bank Board to insure that certain consumer protections are included in these preempted loans and credit sales. Although the conference report to the bill made it very clear these consumer protections would not preempt stricter State laws in the same area, the Bank Board rule as promulgated says otherwise.

It says that creditors need comply only with the provisions of this section unless the Board determines that a State law gives more protection to the consumers. Then if the Bank Board decides that the State law gives greater protection, the State law operates

only prospectively. This is an excellent example of how a little bit of preemption can be expanded by bureaucratic usurpation.

Also to be mentioned is the fact that Public Law 94-221 in an historically unprecedented move extended the National Bank Act provisions concerning national bank interest rates to those for all State-chartered substitutions. The approach shifts the burden to the State to justify a policy concerning interest rates that had already been made and constantly under review by the State legislature.

I should also mention that we have also been impacted by the Federal Reserve Board's preemption of State law by means not of the law but of a regulation. The Federal Reserve Board preempted State laws that regulate how changing the terms of open-end credit plans can occur. That preempt set in motion a whole chain of pressures at State levels to reexamine other State laws having to do with regulating the cost of open-end credit.

In Maine, it has meant pressure on our requirement for a 25-day grace period prior to the imposition of a finance charge on current purchases, our prohibition of an annual membership fee for a lender credit, and maximum rate structure for open-end credit itself, which in Maine is 18 percent.

The Truth in Lending Simplification Act also added additional burdens on those States who want to keep their Federal truth in lending exemption.

One thing the act is not, and that is simple. We will have to totally revise our State truth in lending law and regulations in response to this initiative.

COMPTROLLER REFUSES EXAMINATION

I would also like to bring to your attention another area that has not been mentioned here today as a reason why we also support your proposal. This area concerns the relationship between Federal and State regulators of consumer credit and specifically the role of Comptroller of the Currency in enforcing State consumer credit laws. The Comptroller refuses access to national banks by State officials even for the limited purpose of examination for compliance with consumer credit laws.

We must then ask ourselves whether the consumers who deal with national banks in Maine are as protected as the consumers who deal with those over which we have direct examination and enforcement authority.

We engaged in a dialog with the Comptroller to try and clarify this issue. We have assisted the Comptroller in designing examination procedures for use in Maine so as to assure compliance with the Maine Consumers Credit Code. We do not know, of course, how they are being used in the field. But there are a number of questions that have remained unanswered throughout this dialog. We have asked the Comptroller many times to declare to us the authority upon which he relies, to monitor and seek compliance with State consumer credit laws. No response has been forthcoming. We requested to be kept informed as to the number and types of violations that have been discovered by virtue of their examination for compliance with Maine law. The data we have recently received I have attached to my testimony. He tells us the number of custom-

ers that have been reimbursed $14,000, approximately, as a result of violations. Then he enclosed a chart listing those sections of law violated and how many violations were found. Only five violations of three different sections of the Maine Consumer Credit Code have been cited by the Comptroller. What is more incredible, we do not know the following facts to enable us to interpret the data: The time period during which these examinations took place; whether or not the aggregate figures stated in the letter included violations of regulations, a Federal law, as well as the Maine Code, or other Federal consumer statutes; the time period during which the violations occurred; the number of transactions reviewed; how the dollar amounts in the letter relate to the violations it has cited in the chart. It is difficult for us to compare the Comptroller's ability to detect violations and protect consumers with that of our bureau, but I offer the following figures from our States: During our fiscal year which ended June 30 this year, the bureau conducted 244 examinations of all kinds of creditors, reviewed approximately 46,000 transactions. We found 412 violations of the consumer credit Code and 574 violations of the truth in lending law.

We have returned over $34,000 to Maine consumers through our restitution program as a result of these violations. It is a very low rate of violation, I might add. We have good compliance in Maine because we do frequent and comprehensive examinations.

Third, the Comptroller has yet to inform us whether or not he will enforce not only the substantive credit law provisions of the code but whether he will enforce the procedural rights and the remedies given to consumers and imposed upon the administrator of the code.

As an example, I might point out that under the code I am required to notify consumers of violations I find so that they may know the rights of action that they have to seek their own remedy under the laws. Obviously, if consumers do not know there has been a violation and do not know their rights, it is as good as not having them in the statute.

The Comptroller refuses to comply with that provision of the law. They make the bank notify the consumer that there has been a violation and the bank, of course, does not tell the consumer that individual has a right of action. Even as a result of these several months of intensive contact between our State and Comptroller, it is quite clear we are not capable of insuring consumers who deal with national banks that they are protected in the same manner as those who deal with other institutions where we have direct examination authority. I would like to propose this type of issue be added to the agenda of the consumer usury study commission.

I will not go over again the agenda of further Federal preemption that is either in the talking, drafting, or actual stages. That will come before this Congress in the next year. Suffice it to say that to continue to negotiate piecemeal preemption of substantive State contract law is dangerous in many ways.

First, Congress lacks important information as to the need for preemption at any particular time. Not too many weeks ago, Senator Baucus, from Montana, proposed to add an amendment onto a totally unrelated piece of legislation which would have preempted State maximum motor vehicle contract rates.

We did a survey of 11 States who purportedly had interest rates of 16 percent or less and were the basis for the need for the amendment. We found that four of the States had by legislative action increased the rate just recently beyond 16 percent.

Two States had legislation pending to increase the rate beyond 16 percent. Four States had just recently increased their rate or had affirmatively decided that no change in the current rate structure was justified.

Only one of these States had no action either pending or recently taken.

I believe the survey demonstrates two things: One, the States can respond when necessary.

Two, Congress is often not aware of up-to-the-minute and crucial information necessary to determine if Federal preemption is desirable. Congress currently lacks the information to project the impact of Federal preemption. Not only does Congress preempt the actual State law, they know they are preempting, but often because questions do arise about related State legislation of which for the most part they were unaware when taking action.

In addition to the policy issues with respect to whether or not any particular State law should be preempted, no one has really analyzed the enforcement and constitutional implications of further Federal preemption.

Who will enforce the new Federal rules? At what cost? Should enforcement be delegated to the States? If Congress does not delegate to the States, will it be content with the inevitable result of decreasing State enforcement efforts?

I would suggest that these constitutional implications are as important to the debate surrounding Federal preemption as the actual decision about what the law should be. I do have a number of suggestions with regard to the study commission.

I have a tendency to believe that to engage in a debate concerning the need for usury limits and their proper level may not be particularly useful. That debate is never ending and cannot be decided by any group of nonelected officials. It is a political decision of the first magnitude and there have been studies on that issue many, many times.

Senator MITCHELL. Do you think that political decision should be made in Washington for each of the 50 States or should the State make that decision?

STUDY COMMISSION TO MAKE DECISIONS

Ms. ALEXANDER. That is what the Commission ought to decide: Where is the proper forum for making the decision? Whoever makes the decision will have to decide if there should be rates or should not be rates.

But who should make the decision is what the agenda of the Commission is all about. The Commission should assume that interest rates will be regulated. Whether or not the regulation is a decision to enact maximums or remove them.

The study commission will be able to make a real contribution to the debate by focusing on describing the existing system, describing the manner in which these rates are set now, and making recom-

mendations concerning the proper forum for making future decisions.

I would also emphasize that I believe strongly that the interest rate decision can't be divorced from the substantive contract decision. The rate and the contract decisions and consumer protection and creditor remedies, all must be viewed as an integrated whole.

They certainly were in every code State that went through the process of adopting the code. There is an intimate link between the level of interest rates established and the kind of consumer protections you demand in that situation.

Certainly in Maine, the relatively high rates adopted were as part of a package incorporating a number of strong consumer protections as tradeoffs for the level of interest allowed to the creditor.

Senator MITCHELL. Do you find that the creditor representatives were receptive to that? If they get high enough interest rates they are willing to accept this?

Ms. ALEXANDER. There is no question, for instance, that our prohibition on contracting for attorney's fees in contracts with a rate over 12¼ percent was seen as a definite—in other words, the tradeoff was they could move up to 18 percent with a contract rate and hide those costs in the rate. It's clearly a decision that has to be made.

Will you hide those costs in the rate and spread the burden, or will you set a rate at the artificially low level and require the creditor to get extra costs on top of that?

Maine decided the latter way—the former way. I strongly recommend the agenda include the analysis of existing relationships between Federal and State regulators in the enforcement of State law and the Commission should make recommendations on how to get the job of enforcing State law done in the national banks.

I also think it is vital, and I am sure you realize, that the Commission must have adequate funding to hire staff and necessary consultants to conduct its business. I don't need to tell you how a lack of funds may strangle the ability of the Commission to make a report useful to you.

Senator MITCHELL. This is a difficult year in terms of budget and fiscal restraints. There is great pressure on the Federal budget. A substantial deficit despite indications earlier this year that next year's budget would be in balance.

What am I to say to those who say we can't do everything we want to do? There are valid social objectives in the Nation that require Federal assistance. Why is this so important?

Ms. ALEXANDER. A response might be to engage in the—the alternative to this is to take up the agenda you will be faced with in the next session and that you are faced with now with regard to this bill or any of the other proposals.

Senator MITCHELL. What is wrong with that? Those favoring Federal preemption can make their argument here and those opposing it can come here and make their argument.

Ms. ALEXANDER. Correct, but taking it up on a piecemeal basis means the constitutional implications of all of them wouldn't be analyzed at the same time and the cost that will result from piecemeal preemption will be imposed not only on the Federal

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Government to enforce new rules, but on the States who must react to what you have done.

I think it's more efficient to approach it as a package deal, whichever way it comes out.

Senator MITCHELL. Could a fair argument be made that if we do permit further Federal preemption in all of the areas suggested here this morning in the testimony, that the ultimate cost to the Federal Government in terms of enforcement and regulation will far exceed the cost of the study commission which showed to us that it wasn't necessary in the first place? Would that be a fair argument?

Ms. ALEXANDER. I think so, simply because taking up the agenda piecemeal will result in a pretty inefficient way of handling that decision.

Senator MITCHELL. Who is enforcing the prior preemptions now? As you know, Congress recently preempted State law in certain areas. Precisely what you are suggesting should not continue. Who is enforcing that law?

Ms. ALEXANDER. One of the problems with those is in some cases nobody was given authority to interpret what they mean. There was quite a dialog and there may be a lot of cases in court as a result of it.

Senator MITCHELL. Is there enforcement? Someone in a State that is affected, can they disregard it?

Ms. ALEXANDER. I don't know who will enforce the mandatory consumer protection provisions on mobile homes and loans and sales. No provision was made——

Senator MITCHELL. What is there to enforce when you preempt a usury law?

Ms. ALEXANDER. The condition for preemption with mobile homes was certain consumer protection appears in the contract. Who will check to make sure that occurred?

Senator MITCHELL. Who does it now?

Ms. ALEXANDER. Nobody.

Senator MITCHELL. Is the law silent on that?

Ms. ALEXANDER. That's correct. I can imagine some real problems there. Why should the States take it upon themselves to make special—unless they are directed to do so.

Senator MITCHELL. Even if they were inclined to do so, there are smart lawyers around, and the first time the State came in to enforce it, they would say, what authority does the State have to enforce Federal law?

Ms. ALEXANDER. That's right. Maybe the Federal banking regulators should be enforcing it. Fine for banks and savings and loans and credit unions. However, they don't regulate mobile home credit sellers. Not really.

One of the problems with the last round of Federal preemptions was they were negotiated in a conference committee with no hearings to analyze the implications. The most dangerous kind, clearly.

I would also like to make a few comments about the process I would hope the Commission would follow in arriving at its recommendations. I would suggest the Commission be mandated to first gather facts and options by means of its own staff input and then

prepare a draft report and then propose in this draft report goals and objectives, and suggest various options and/or implications.

The draft report should then have the widest possible circulation. Hearings should be held to gather reactions and additional information. A final report should then be prepared.

I have been involved in public interest activities for many years. I have been an observer and participant in various programs which seek to involve the public in the decisionmaking process.

I would hope that the Commission would have a vehicle to go to regional hearings with. I think public hearings without a document to review and react to often become a useless exercise.

Senator MITCHELL. Does the public care about this area?

Ms. ALEXANDER. Clearly, with any action at which political decisionmaking has to take place, there is a group of people who are more concerned than others. In our democratic process, the great majority of the people don't all participate in every issue that impacts on them. It depends on who cares enough as to who gets organized.

Senator MITCHELL. I travel around the State of Maine and meet with thousands of people. I have been to hundreds of political meetings where other political figures have gone. I can't remember anybody asking a consumer question.

Do people really care?

Ms. ALEXANDER. The people that come to our office certainly care.

Senator MITCHELL. Who have a specific complaint?

Ms. ALEXANDER. Yes.

Senator MITCHELL. Look at polls. Americans are asked by everybody, "What is the biggest problem on your mind?" Taxes, spending, Iran, Afghanistan. On the bottom is a category that says "Other, 2.3 percent." That is usually where consumer affairs are.

Do people really care?

Ms. ALEXANDER. I think people who have a problem really care. I think that it is not an issue on which great comment is taking place on the street corner. Clearly not. Consumer credit and decisions surrounding credit are overwhelming to most people. They are not educated in their schooling to think about credit and the cost of credit and what their options are.

TAKE IT OR LEAVE IT

Credit is presented to the American consumer when they need it. They only go after it when needed. It's presented on a "take it or leave it" basis. A form contract is put in front of them. There is not much debate about terms. Most people don't realize what power they have in the transaction.

Senator MITCHELL. Suppose this goes forward and I get up on the floor and say, "I think we need this Commission," and someone else says, listen, we had thousands of government studies, and if there is one thing the public is cynical about, it's another Government study. How many have we had? 80,000? What is so special about this? Why should anybody care about this? Nobody in Arkansas or West Virginia or Idaho or Iowa came to me—I hypothetically say these—why should we have another study and do another Federal study that would be buried on another shelf and nobody

cares about this. Don't we have enough pressing problems the people are beating down the doors to get us to resolve.

What do you think I should say?

Ms. ALEXANDER. I think the reason why this study would be useful is because you have before you an upcoming agenda, that deciding either way upon it will mean major changes in the way we regulate consumer credit.

Before you embark on those, you know you will hear from creditors and consumers about what you should be doing in this area, and before you embark on that road, whatever road it is you decide to take, it would be a good idea to know the implications of it.

It may be that this Commission will recommend that State laws are a mess and no creditor in his right mind can deal with it, and what we need is a national consumer credit code. It may be that this Commission will find a growing level of——

Senator MITCHELL. Everybody who testified today will have to come in and reverse their position then.

Ms. ALEXANDER. Because they don't ask for rate relief and not consider the consumer protection side of the question.

Senator MITCHELL. The only problem is you say it's useful. Lots of things are useful. Is it necessary? Compelling? Remember, this is competing with enormous and valid demand upon the Federal resources.

Can I in good conscience say these thousands of dollars, $300,000 or $500,000 or $800,000 of taxpayers' money, will be spent on this study, should that go here instead of going to some other program? Weatherization of Maine homes for the elderly who can't afford to heat their own homes, for example, another missile somewhere to protect this country; the whole myriad demand on the Federal budget.

What compelling argument can be made?

Ms. ALEXANDER. The answer to that question has to be to ask you a question. Are you comfortable taking up the agenda that you know is coming before you without knowing the answers to some of the questions I raised? If you are comfortable in making those decisions, don't go through the charade of a commission.

If this committee feels they know enough to make those decisions now, do it. My impression was there might be questions unanswered that you will not get from partisan testimony, or you will not get from studies done by the people proposing the legislation. That is the answer I can give.

I would like to—I am finished with my testimony. I just have one thing I would like to do in reaction to a previous speaker. It was one of the banking organizations that suggested as an alternative to the study commission, the Federal task force approach to this.

I would strongly object to it, not only for the obvious reason that the task force would have no State official on it, but because of that task force; of the five, three of them regular commercial banks; the Federal Reserve Board, Comptroller of the Currency, and FDIC. They regulate commercial banks primarily for the purpose of assuring the financial stability of those discussions.

The consumer duties those organizations fulfill were imposed on them reluctantly as a result of congressional hearings, some of which took place before this subcommittee in the mid-1970's.

The other two officials proposed as members of the task force, one of them would be Secretary of Treasury, the present incumbent of which is an outspoken proponent for preemption of State usury ceilings. The other one, the Home Loan Bank Board, is regulating institutions whose ability to make consumer loans recently was vastly expanded.

Senator MITCHELL. You think those who proposed a Federal interagency task force be used for this purpose had in mind they might get a result favorable to preconceived positions?

Ms. ALEXANDER. I am trying to say exactly that in a polite way.

Senator MITCHELL. Just as you have in mind they will take a position opposite yours.

Ms. ALEXANDER. That's correct. I base that on public statements they made. The duty Congress gave them is not consumer credit.

Senator MITCHELL. Thank you very much.

[The complete statement follows:]

Barbara Reid Alexander
Superintendent
Harry W. Giddinge
Deputy Superintendent

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Hallowell Annex
Hallowell, Maine

DEPARTMENT OF BUSINESS REGULATION
BUREAU OF CONSUMER PROTECTION
STATE HOUSE STATION 35
AUGUSTA, MAINE 04333

TESTIMONY OF BARBARA R. ALEXANDER,
SUPERINTENDENT,
MAINE BUREAU OF CONSUMER PROTECTION

BEFORE THE CONSUMER AFFAIRS SUBCOMMITTEE,
U. S. SENATE BANKING,
HOUSING AND URBAN AFFAIRS
COMMITTEE

JULY 24, 1980

Thank you very much for inviting me to testify before you today concerning H.R. 7340, The Cash Discount Act, and Senator Mitchell's proposal to establish a Consumer Usury Study Commission. I represent the State of Maine and the American Conference of Uniform Consumer Credit Code States. The Conference is an organization composed of the 11 states that have adopted a version of the Uniform Consumer Credit Code (Indiana, Oklahoma, Wyoming, Kansas, Wisconsin, Maine, Colorado, Iowa and Idaho). The UCCC is a comprehensive statute that regulates consumer credit: licensing, interest rate structure, and consumer protections and creditor remedies. This statute recognizes the intimate connection between two very important policy decisions in regulating consumer credit, that is, the establishment of maximum interest rates and the protections afforded the consumer in the content and enforcement of the consumer credit contract. The UCCC also adopts the Federal Truth in Lending Act. Three of the states, Maine, Wyoming and Oklahoma, are exempt states for Truth in Lending.

I would first like to address H.R. 7340, The Cash Discount Act. This proposal would remove the current maximum 5% allowable discount that can be given by a merchant for the payment in cash as opposed to payment by credit card. This is clearly a needed reform to encourage a more informed consumer choice in the decision to pay either in cash or by use of a credit card. Removal of the maximum 5% discount will allow cash customers to avoid unnecessary subsidy of charge customers. The Conference supports this bill and testified to this point before the House Banking Committee several months ago.

You have also asked for comments as to whether or not there is a need to authoize the use of surcharges. The Truth in Lending Act prohibits the imposition of a surcharge by the merchant when a consumer pays by credit card. The Conference does not have a position on this issue, but my view is that a surcharge is an increase in the cost of credit to that customer, a cost that should be disclosed as part of the annual percentage rate for the use of the card.

Your proposal to establish a Consumer Usury Study Commission is well considered and very timely. You have the full support of the State of Maine and the Uniform Consumer Credit Code administrators with this proposal. Indeed, at our latest meeting in May, 1980, the Conference adopted a resolution which I have appended to my testimony. That resolution, in pertinent part, "urges that the United States Congress undertake no further preemption of state laws with respect to consumer credit rates, charges or practices so as to allow the individual states an opportunity to study and enact needed reforms in their consumer credit statutes and urges the consumer credit administrators in all other states to support this position."

The Consumer Credit administrators have taken this position for a number of reasons, all of which support the need for swift action on your proposal.

In the last several months, Congress has undertaken a number of new initiatives in preempting or substantially impacting on state consumer credit laws and regulations. First, The Depository Institutions Deregulation and Monetary Control Act of 1980 preempts state usury laws in three areas effective April 1, 1980. Although the preemption with respect to business and agricultural loans in excess of $25,000 does not affect Maine, the preemption with regard to state maximum rates in two other areas is important. The law preempts the maximum rate for first lien mortgages on residential real property or on residential manufactured homes. While the Maine Consumer Credit Code does not regulate most first lien mortgages on residential real property, it does regulate mobile home credit sales and loans. The federal preemption made a recently enacted increase from 13% to 18% in the maximum rate for these transactions a nullity.

In addition, the Act requires regulations, which have now been promulgated by the Federal Home Loan Bank Board, in order to insure that certain consumer protections were incorporated into any mobile home loan or credit sale prior to qualifying it for the federal preemption. Although the Conference Report to the Act quite clearly stated that these consumer protection provisions would not preempt more strict state consumer protections, the final regulations from the Federal Home Loan Bank Board have not conformed to this policy. The Bank Board rule as stated in 12 CFR Part 590.4(b)(2)(B) is that "Creditors need comply only with the provisions of this section, unless the Board determines that an otherwise applicable state law regulating matters covered by this section provides greater protection to consumers. Such determination shall be published in the Federal Register and shall operate prospectively." This provision, of course, completely shifts the burden to the state administrator to demonstrate that their law is more strict than the federal rule. If the Bank Board agrees with the state administrator, compliance with an otherwise applicable state law is only prospective. This is an excellent example of how a little bit of preemption by law can be expanded by bureaucratic usurpation.

Public Law 96-221 also preempts state usury laws for any other kind of loan and gives state-chartered financial institutions the same rights to exceed state usury laws as are presently enjoyed by national banks by virtue of the 19th Century National Bank Act. The maximum is now state rates or 1% in excess of the discount rate for 90-day commercial paper in effect at the Federal Reserve Bank where the financial institution is located, whichever is greater. This preemption is permanent unless the state adopts a law which explicitly overrides the federal preemption. Again, I would note that this approach shifts the burden to the state to justify a policy decision already made by the State Legislature.

These historically unprecedented preemptions of state usury law were both adopted in a particularly unfortunate manner. These proposals surfaced during the debate within the Conference Committee on House and Senate version of H.R. 4986. No hearings were held on whether or not these expanded preemptions were proper. No hearings were held on the possible impact of the preemptions on state law. No hearings were held on the desirability or the feasibility of allowing states to respond to the rapid shifts in market conditions that were current in early 1980.

In addition to the preemptions enacted by Congress, the Federal Reserve Board entered the arena of federal preemption by means of a regulation. The Credit Restraint Program was announced on March 14, 1980 in response to the invocation of the Credit Control Act of 1969 by the President. This Act delegates to the President and the Federal Reserve Board the complete and unfettered ability to preempt any state credit law when the President declares that it is necessary to do so. The recent Credit Restraint Program attempted to make it more costly for all creditors to continue the growth of unsecured and open-end credit. In order to allow a quick response on the part of creditors, the Federal Reserve Board preempted any state law governing a change in the terms of open-end credit. The preemption in the change of terms rule and the provisions of the credit restraint program itself have resulted in political pressure by lenders in Maine and in other states to reexamine other state laws, such as the requirement for a 25-day grace period prior to the imposition of a finance charge on current purchases, the prohibition of an annual membership fee for a lender credit card, and the maximum rate structure for open-end credit plans, which in Maine is 18%. Preemption of state laws sets in motion additional pressures on both the states and the Congress due to the integrated nature of these policy decisions.

In addition to preempting state usury laws in certain areas, Public Law 96-221 also enacted the long-debated Truth in Lending Simplification Act. This is a quite significant and major overhaul of the 1969 Federal Truth in Lending Act and will, as you know, require a complete revision of the rules contained in Regulation Z for the disclosure of consumer Credit. One thing the Act is not and that is "simple." These changes have particular importance in Maine and in the other exempt states because we have been delegated the power to enforce this law. Those states who wish to maintain or apply for an exemption will have to enact a total revision of their state Truth in Lending law and regulations.

In addition to the Truth in Lending Simplification Act's impact on the Maine Code, the new requirements concerning the content and placement of disclosures will have a significant impact on Maine's plain language Consumer Loan Agreement Law. There is a growing trend, at least in Maine, toward combining simple interest note and disclosure forms. However, instead of integrating truth in lending disclosures into the note itself and expressing all of these terms in plain language, the creditor must now either segregate all of the truth in lending disclosures beginning on the front of the contract document or give truth in lending disclosures on a separate piece of paper, thus increasing the paper work associated with a consumer credit transaction.

I would also like to bring to your attention another area of immediate concern that impacts the current and future relationship between federal and state regulators of consumer credit and that is the role of Comptroller of the Currency enforcing state consumer credit laws. As you know, the Comptroller refuses access to national banks by state officials even for the limited purpose of examination for compliance with consumer credit laws. I believe it is then legitimate to ask whether the Comptroller is in fact insuring that the consumers of Maine who deal with national banks are as protected as those who deal with state-chartered institutions. We have been engaged in a dialogue with the Comptroller in order to clarify this issue. We have assisted the Comptroller's examination staff in devising examination procedures for use in Maine so as to assure compliance with the substantive provisions of state law. On paper these examination procedures seem to be adequate. We, of course, do not know how they are being used in the field.

There are a number of questions that have remained unanswered throughout this dialogue. First, we have requested several times in writing that the Comptroller declare to us the authority upon which he relies to monitor for and seek compliance with state consumer credit laws. To date, no response has been forthcoming other than an assurance by the Comptroller that he recognizes this duty.

Second, we have requested to be kept informed as to the number and types of examinations that have been discovered by virtue of examination for compliance with Maine law. Just recently we received a response which I have attached to my testimony. In it, Mr. Heimann, Comptroller of the Currency, states that they have "researched our files and have determined that 2,376 customers of Maine national banks have been reimbursed $14,452 as a result of violations cited in consumer compliance examinations." Attached to his letter was a chart which is composed of two columns. The first column states the section of either Regulation Z or the Maine Consumer Credit Code violated by any institution, and the second column contains the number of citations of that violation found. As you can see, only five violations of three different sections of the Maine Consumer Credit Code have been cited by the Comptroller. I also attached to my testimony my response to Mr. Heimann upon receipt of this information. Mr. Heimann does not tell us the following key points which would allow

us to make use of and interpret this data: the time period during which these examinations took place; whether or not the aggregate figures stated in his letter include violations of Regulation Z as well as the Maine Code or other federal consumer statutes; how the figures of his letter relate to the attached chart which sets forth specific violations and the number of citations; the time period during which the violations occurred; and the number of transactions reviewed. It is difficult to compare the Comptroller's ability to detect violations with that of our Bureau. During the fiscal year ending June 30, 1980, the Bureau conducted 244 examinations, reviewed approximately 46,000 transactions and cited 412 violations of the Code and 574 violations of truth in lending for an overall violation ratio of 2.14%. As a result of our restitution program, over $34,500 was returned to Maine consumers.

Third, the Comptroller has yet to inform us whether or not he will enforce not only these substantive contract law provisions of the Maine Code but whether he will also enforce the procedural rights and remedies given to consumers and imposed upon the administrator of the Code. I propose that if, in fact, the Comptroller has the authority and the obligation to seek compliance with state laws, a proposition yet to be resolved, then he has the obligation to enforce all of the provisions of the Maine Code, not those he merely chooses to enforce. Even as a result of several months of dialogue between the State and the Comptroller, it is quite clear that we are still not capable of assuring consumers who deal with national banks that they are protected in the same manner as consumers who deal with other institutions over which we have direct examination authority. This type of issue must be added to the agenda of the Consumer Usury Study Commission.

So far, my testimony has detailed the actual result of the existing federal-state regulation of consumer credit. However, as you well know, there are a number of recent proposals floating around which have emanated from both lenders and consumers which would result in a further drastic imbalance in the federal-state regulatory program. The American Bankers Association has an avowed aim to preempt all state usury limits permanently. The VISA International System is proposing legislation which would preempt any state law with regard to charging transaction costs in the use of the credit card by the consumer. More recently, Senator Baucus of Montana attempted to attach an amendment to the National Housing Authorization Act which would have preempted state laws with respect to maximum interest rates on motor vehicle contracts. Consumers have not been quiet in this recent flury of activity. You have under consideration before you a bill which would preempt state laws with regard to the use of the Rule of 78's in contracts in excess of 61 months and require instead the use of the actuarial method in calculating a rebate to the consumer upon prepayment. The Federal Trade Commission will shortly publish staff recommendations on the far-reaching and long-awaited credit practices rule. This rule regulates creditor practices in eight specific areas, all of which are addressed by the Uniform Consumer Credit Code.

It is clear that your proposal for a Consumer Usury Study Commission is both timely and important. Otherwise, we will continue to negotiate piecemeal preemption of substantive state contract law. There is a real danger in the continuation of the piecemeal approach.

First, the Congress lacks important information as to the need for preemption of state laws. For instance, just prior to the attempted amendment by Senator Baucus concerning maximum motor vehicle contract rates, the State of Maine did a survey of 11 state who purportedly had maximum interest rates of 16% or less. As a result of our survey, we found that four of these states had recently, by legislative activity, increased the rate beyond 16%, two states had legislation pending to increase the

rate beyond 16%, four states had either just recently increased their rate or had affirmatively decided that no change in the current rate structure was justified. Only one state had no action either pending or taken in the recent months with regard to this issue. I believe that this survey demonstrates two things. (1) That the states can respond to necessary changes in the economic system; (2) the Congress is not aware of up-to-date and crucial information necessary in order to determine whether federal preemption is desirable.

In addition to having information gaps about the current situation that determines whether or not preemption is necessary, Congress also currently lacks the information to project the impact of any federal preemption on various state laws. By this I mean that Congress is often not aware of the impact a federal preemption may have on related but not totally duplicative state legislation. For instance, when Congress preempted state usury ceilings for state-chartered institutions in Public Law 96-221, it may not have been aware that the State of Maine has a number of provisions designed to protect consumers that are triggered by the level of interest rate charged. One provision of the Maine Code prohibits a lender from increasing the rate upon refinancing a contract by more than ¼ of 1%. This provision was deliberately adopted by the Maine Legislature in order to prohibit the lender from taking advantage of a mutual mistake of fact, a mistake by the creditor on the consumer's ability to pay, and a mistake by the consumer as to his ability to pay the lender. Was this contract provision also preempted by the terms of Public Law 96-221? In addition, there have been quiet debates surrounding the meaning of the preemption of the state maximum interest rate. Does it preempt the ability of the states to regulate additional charges which are excluded from the finance charge? Does the preemption refer to the note rate or to the annual percentage rate as required to be disclosed under truth in lending? These issues arise because of hasty action and lack of consultation prior to Congressional action.

In addition to the policy issue with respect to whether or not any particular state law should be preempted, no one has really analyzed the enforcement and regulatory implications of further federal preemption. Who will enforce the new federal rules? What enforcement should or can be delegated to the states with regard to federal laws? If the Congress delegates enforcement of new federal rules to federal regulatory agencies, will it be content with the inevitable result of decreasing the often questionnable state enforcement efforts that exist now? These and many other institutional implications to further federal preemption are explored masterfully by Ralph J. Rohner in two recent articles in the Catholic University Law Review entitled, "Problems of Federalism in the Regulation of Consumer Financial Services Offered by Commercial Banks" (1979-1980). Mr. Rohner suggests a number of options which would clarify and contribute to the debate over the proper federal-state regulatory structure and I would hope that the Study Commission that you are proposing today will look very closely at the suggestions and the alternatives he outlines.

I have a few specific proposals with regard to the Study Commission itself. First, you propose three basic needs that must be addressed by this Commission: (1) an analysis of existing and/or proposed usury ceilings; (2) consumer protections and creditor remedies, i.e., the regulation of the contract between the lender and the borrower; and (3) recommendations on the proper balance to be struck in federal-state substantive law and institutional requirements. You have suggested in your proposal that there is a need to study the correlation between the rates of interest and the availability of consumer credit, as well as the extent of the evidence of interest rate competition of the various sectors of the consumer credit market. I question whether there is need again to enact another chapter of the endless debate

on the need for usury ceilings or their proper levels. This type of issue alone would be enough work for the Commission for a year and its resulting recommendations have no particular guarantee of being any more successfully enacted than previous national and regional reports and studies. The Commission should assume that interest rates will be regulated, whether or not this regulation is a decision to enact certain maximums or to remove those maximums in lieu of free market competition. I believe the Study Commission should concentrate on identifying the proper institutional mechanism for making that decision, i.e., whether it should be the United States Congress, State Legislators, or some regulatory body. Whether or not maximum interest rates are needed is a political decision of the first magnitude. The Study Commission will be able to make a real contribution to the debate by focusing on describing the existing system, describing the manner in which these rates are set, and making recommendations concerning the proper forum for making future interest rate decisions.

I want to strongly recommend that the agenda of the Study Commission include an analysis of the existing relationship between federal and state regulators in the enforcement of state law. The Commission should make recommendations on how to get the job done.

It is vital that this Commission have adequate funding to hire the staff and consultants it will need to conduct its business over the next year. I do not need to tell you how a lack of funds may strangle the ability of this Commission to make a report useful to you.

I would suggest the following process be mandated in order that the Commission arrive at recommendations for the President and the Congress that have seen the greatest possible public participation. First, I would suggest the Commission be mandated to gather facts and options by means of its own and staff input. Then a draft report should be prepared. The Commission may want to propose goals and objectives, and suggest various options and their implications in this draft report. This draft report should then have the widest possible circulation among consumers, state and industry press and trade associations. At this point hearings should be held as you recommended around the country to gather reactions and additional factual information. The Commission can then retire with the results of its fact-gathering comments to write a final report to you. I have been involved in public interest activities for many years and I have been an observer and a participant in various programs which seek to involve the public in the decision process. It is my experience that merely to hold hearings to gather information with no focus for those hearings is often a useless exercise. Just as the Congress holds hearings on specific proposals in the form of bills, so the Commission should be required to have a product to which all sectors of the consumer credit industry can react.

Thank you very much for the opportunity you have given me to testify before you today. I will certainly be pleased to answer any questions that you may have.

AMERICAN CONFERENCE OF UNIFORM CONSUMER CREDIT CODE STATES
"to achieve cooperation among UCCC Administrators"
ACUCCCS - FOUNDED 1972

RESOLUTION

WHEREAS, Congress passed the Depository Institutions Deregulation and Monetary Control Act of 1980 (P.L. 96-221), Title V of which preempts State laws limiting rates and charges on certain consumer credit transactions; and

WHEREAS, Title V, Sections 501 and 521 preempt the Uniform Consumer Credit Code as adopted in the various Code States for certain consumer loans and consumer credit sales made after March 31, 1980; and

WHEREAS, Congress has and will have under consideration further efforts to preempt State laws governing maximum rates, charges and practices involving consumer credit; and

WHEREAS, the regulation of the rates, charges and practices in the consumer credit field has traditionally been left to the States (see, e.g., Truth in Lending Act, Section 111(b); 15 U.S.C. Section 1610); and

WHEREAS, the Uniform Consumer Credit Code is a balanced State law whose purposes include providing rate ceilings to assure an adequate supply of credit to consumers and protecting consumers against unfair practices by some suppliers of consumer credit, having due regard for the interests of legitimate and scrupulous creditors; and

WHEREAS, Sections 501(b)(2) and 525 permit the States to adopt a law explicitly and by its terms stating that a State does not want the various provisions of Title V to apply to consumer loans and consumer credit sales made in such State.

NOW, THEREFORE, BE IT RESOLVED by the American Conference of Uniform Consumer Credit Code States that the Conference reaffirms its support of the Uniform Consumer Credit Code as adopted by the various States, including its provisions on rates and charges and limitations on agreements and practices, as the proper approach to assuring an adequate supply of consumer credit and specifically declares that Federal legislation in this area is undesirable, unnecessary and has, in many cases, resulted in the preemption of State laws more responsive to the needs of the citizens of the individual States; and

BE IT FURTHER RESOLVED that the American Conference of Uniform Consumer Credit Code States urges that the United States Congress undertake no further preemption of State laws with respect to consumer credit rates, charges or practices so as to allow the individual States an opportunity to study and enact needed reforms in their consumer credit statutes and urges the consumer credit administrators in all other States to support this position; and

BE IT FURTHER RESOLVED that the American Conference of Uniform Consumer Credit Code States urges the individual States to promptly review their States' statutes preempted by P.L. 96-221 and seek to override these preemptive effects where it is determined to be desirable so as to demonstrate to the Congress that future preemption of State consumer credit laws is unnecessary in that the States are capable of, and in favor of, regulatory reform to respond to changing conditions in the consumer credit field and urges that the consumer credit administrators in all other States support this position.

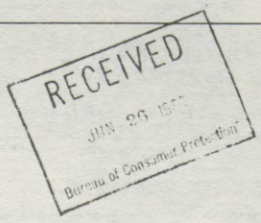
A copy of this Resolution shall be sent to members of the legislature of each Code State, the Congressional delegation of each Code State, and to the President of the National Association of Consumer Credit Administrators.

1-80

May 19, 1980
Hollywood, Florida.

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219



June 23, 1980

Ms. Barbara Reid Alexander
Superintendent
Bureau of Consumer Protection
State House Station 35
Augusta, Maine 04333

Dear Ms. Alexander:

This is in response to your earlier request for a list of Regulation Z and the State of Maine Consumer Credit Code violations by national banks in Maine. We have compiled the list in numerical order of citation, accompanied by the number of times the violation was cited in Reports of Examination.

Your other request concerned reimbursement to the bank's customers. We have researched our files and have determined that 2,376 customers of Maine national banks have been reimbursed $14,452 as a result of violations cited in Consumer Compliance Examinations.

We hope the foregoing has been responsive to your inquiry.

Sincerely,

John G. Heimann
Comptroller of the Currency

Enclosure

Violations of Regulation Z and the Maine Consumer Credit Code	Number of Citations
226.4(a)(5)	7
226.4(a)(7)	1
226.4(b)(1)	3
226.4(g)	4
226.4(h)	1
226.5(b)	15
226.5(d)	1
226.6(a)	4
226.6(c)	1
226.6(i)	1
226.7(a)(2)	1
226.7(a)(4)	1
226.7(a)(9)	4
226.7(b)(1)(VIII)	2
226.7(b)(1)(X)	2
226.7(d)(5)	1
226.8(a)	2
226.8(b)(2)	4
226.8(b)(3)	5
226.8(b)(5)	2
226.8(c)(6)	1
226.8(d)(1)	12
226.8(d)(2)	4
226.8(d)(3)	5
226.8(e)(1)	3
226.9(a)	4
226.9(b)	3
226.9(c)(1)	1
226.10(c)	1
226.10(d)(1)	2
226.13(b)(4)	1
226.13(1)	4
226.13(j)	2
Me 2-308(3)	1
Me 2-401.7(b)	2
Me 2-504	2

July 2, 1980

John G. Heimann
Comptroller of the Currency
Administrator of National Banks
Washington, D. C. 20219

Dear Mr. Heimann:

Thank you for the information you provided me concerning violations cited of Regulation Z and the Maine Consumer Credit Code in your examination of national banks in Maine. However, I have a number of questions concerning this data.

You stated in your letter that 2,376 customers have been reimbursed $14,452 as a result of violations cited in consumer compliance examinations. During what time period did these examinations encompass? Do these figures relate only to Regulation Z and the Maine Code, or do they include violations based on other federal consumer statutes? How do these figures relate to the attached page which sets forth the specific violation and the number of citations?

Concerning the chart attached to your letter, what time period do these violations encompass? Also, how many examinations resulted in these findings? Also, how many transactions were reviewed that give rise to these findings?

Although the information you provided is certainly appreciated, the figures are not particularly useful unless I can reference them to the information I have requested in this letter.

Sincerely,

Barbara R. Alexander
Superintendent

BA:as

Mr. ERWIN. I am Robert Erwin, chief of the consumer protection division, office of the attorney general, Maryland. Prior to assuming that position some 16 or 17 months ago, I had the perhaps dubious distinction of being heavily involved in consumer credit issues as an attorney at the Legal Aid Bureau in Baltimore, not only in court litigating on behalf of consumers, but also as a lobbyist on behalf of consumers, particularly credit issues before the Maryland State Legislature.

To be sure there is no misimpression, let me clarify at the beginning, my office does not directly regulate grantors of credit. My office administers the equivalent at the State level of the Federal FTC Act. We do, however, become fairly heavily involved in credit issues through interaction with the appropriate regulators at the State level.

Let me, rather than read my testimony verbatim, very quickly and briefly—I hope in the period of about 10 minutes—summarize what I think are the high points of the testimony and the ones I would want to particularly impress upon you orally here today.

First, with regards to H.R. 7340, Maryland passed a similar type statute in 1972 which was effective January 1, 1973. As you certainly know, Congress enacted section 167 in 1974. If the experience in Maryland is anywhere near typical, and I believe it is, I am quite safe in saying virtually no merchants are presently giving cash discounts to cash customers. I think the conclusion is absolutely inescapable that both the State and Federal efforts in this direction over the past 6 to 8 years have been an absolute failure. It has to be put that bluntly.

HIDDEN COST OF CREDIT

In my opinion, the need to move in that direction is the same, and is as compelling today as it was 6 or 8 years ago. It seems to me absolutely clear that to the degree that a merchant and a card issuer would negotiate a discount between the two of them and that money ends up in the pocket of the card issuer, it's a cost of credit. At least as far as the consumer is concerned. It's a hidden cost of credit.

If there is any benefit to consumers in terms of knowing the true cost of credit in making informed decisions about whether or not to use credit, that information must be made known to them and they must have the opportunity to make the decisions as to whether or not to use credit, knowing those facts.

We have not as yet been successful in doing that. To the degree that H.R. 7340 will further that and will at last persuade merchants and be sufficient to encourage merchants to give cash discounts to cash customers, we certainly want to strongly support this Congress enacting that.

Senator MITCHELL. Why do that if previous efforts have failed? Why will this bill do that?

Mr. ERWIN. My concern and reservation I expressed in my testimony is whether or not it goes far enough, particularly in the absence of more directly addressing the discount surcharge issue, to persuade merchants to in fact give that cash discount to cash customers.

In my own personal opinion, for whatever this is worth, the discount surcharge issue is largely one of semantics. I am not sure it makes any real significant difference to consumers what we label this. There may be lots of repercussion to the industry. How it will be dealt with in usury laws is a concern the committee should consider.

I am not sure whether you label it a discount or surcharge will be the end-all and be-all of that discussion or need to be the reason for failure to pass this particular piece of legislation. I think you must address that issue if you are going to be successful with this legislation.

Senator MITCHELL. My question—you just stated all prior efforts have failed.

Mr. ERWIN. That is correct.

Senator MITCHELL. We have authorized cash discounts and nobody has done it. What is the difference? Why go through this exercise now to continue that authorization? What reason is there to believe the failure will end and success will come as a result of this legislation?

Mr. ERWIN. I believe if Congress can resolve the problem surrounding the discounts and surcharges——

Senator MITCHELL. You think if we can authorize or not prohibit the surcharge that will make the difference?

Mr. ERWIN. I think it probably would. I think the major reservation by merchants and the major thing slowing them down from giving cash discounts is the concern as to whether or not that will result in a surcharge and whether or not that will result in violations of the law.

It seems to me very clear that the bottom line is it's in the merchant's interest or ought to be in the merchant's interest. There is at least a conceptual economic advantage to offering that type of discount. At minimum, you have the possibility for additional business to your store.

Senator MITCHELL. What you are suggesting is that merchants now, if they grant a cash discount, may be concerned that in so doing they are imposing a surcharge upon credit card customers and therefore would be violating the law merely by granting the cash discount?

Mr. ERWIN. I believe that legal issue is sufficiently in doubt that merchants are unwilling to run that risk.

Senator MITCHELL. So if the prohibition against surcharges were removed so that it were clear that a merchant could freely grant a cash discount without fear that that might be considered a surcharge, or either in conjunction with or independently of that action impose a specific surcharge for credit transactions, then you think the whole concept might then become more widely used and cash discounts would be granted to a greater degree than they have been in the past?

Mr. ERWIN. That's correct. Simple answer.

Senator MITCHELL. I just want to understand what you are saying. What do you think about my questions to Ms. Alexander? You have been involved in this field seven years at the Consumer Law Center Legal Aid Bureau in Baltimore. Does anybody care?

PEOPLE DO CARE

Mr. ERWIN. There are two levels I would like to answer that on if I may. First the answer is yes. People do care. I am concerned that in my contacts with consumers many if not most of them are so cynical today about the way the market system is working, particularly in the credit area, that they don't feel they can have any effect on it and consequently don't as aggressively voice their concerns about that issue as they do some other consumer issues.

More importantly, you asked Ms. Alexander about is there really a compelling reason to have this commission to study this? Why are we doing it? At the risk of being labeled perhaps a bleeding heart, let me suggest I think there are two absolutely overwhelming reasons why Congress must do this.

First, I think the experience of even the past 6 months alone in terms of the administration's efforts to restrict flow of consumer credit, if nothing else, reenforces what we should already know about the key role that consumer credit plays in our economy.

I stress that because I think it's enormously important that this committee and Congress as a whole understand the potential result of a miscalculation of what would be the result of preempting State usury status. It's possible. I would not purport to be a sufficient expert to say to you if you did it there would be no adverse results. That is a possibility.

There is a possibility of enormously adverse results in terms of economics and the result to our economy. Just in terms of fueling inflation, raising credit rates, interest rates, all of that could have an enormous impact on our economy if you miscalculate what will happen if you do that.

Senator MITCHELL. There is no question, is there, that lifting or eliminating usury ceilings has as its explicit objective the increase in rates?

Mr. ERWIN. Absolutely. How much will it increase and how high will it go and what will the impact on the economy be? If you guess wrong on that, the results to the economy could be enormously serious. I am not an economist or expert in the national economy. But just reading the papers about what happened in the last 6 months when people reduced the use of credit says if you guessed wrong we are in deep trouble.

Second and perhaps more importantly, let me stress upon you my experience in terms of the personal impact of a miscalculation in this area. I have personally seen where low income inner-city residents have been virtually economically enslaved to the one or two creditors who would give that particular family credit to the point where that family may be in debt to a particular store or loan company for 6 or 8 or 10 consecutive years with literally no realistic hope of ever getting out of debt to that particular creditor.

Conversely, in representing middle-income people in filing personal bankruptcies, the amount of personal dislocation to a middle-income family who by reason of easy availability of credit and inability to handle that credit, the loss of the home, the loss of automobiles, the very real personal impacts on that family, I can't describe to you in words. I have literally seen grown, middle aged, white middle class men sit in my office and cry.

Again, a miscalculation by this Congress as to what the result would be if we went ahead and did this can have enormous impact just in human personal terms to the people of our society, ignoring the kind of economic impacts it can have.

What I am suggesting to you is regardless of the merits or demerits of preempting State usury laws, I don't think it's our purpose today to necessarily debate that, the issue is so serious and the economic impacts and personal impacts resulting from an error in judgment on this issue is so serious that I suggest to you you can't act with less than all of the best available information.

The final point I would want to make is that in my experience, unless the process is vastly different in Congress than it is in State legislatures, and I frankly suspect it is not, although I am not experienced here at the Federal level, you don't presently have that information. There is an enormously complex task of balancing interest rates, securities and other consumer protections and the result of the availability of credit at the end.

BANKS REFUSE TO DISCLOSE BASIC FUNDAMENTAL DATA

The hard financial factual data on which to make those judgments is frequently not there. Just the last session of the Maryland State Legislature during bills relating to bank interest rates, the banks in Maryland refused to disclose literally such basic fundamental data as the number of loans granted, the total dollar volume of those loans, even less addressing the more subtle issues such as the cost of money. They were very quick to disclose their incremental cost of money. What it cost them to borrow another dollar in the market today.

Ask them for historic average data. "Tell me how much you have on deposit in checking accounts which are essentially free. Tell me how much you have on deposit in various savings and other demand deposits and what your average interest rates are on those portfolios. Tell me what your other borrowing and lending rate is."

They would not disclose that data. We frankly were totally unable to obtain it from the banks because they refused to disclose their historic average cost borrowing figures. We know it was significantly less than the incremental cost of borrowing another dollar in the market to relend to a consumer back in January or February. We know today it is much lower than it was 4 or 5 months ago.

But I seriously doubt if there is any Member of Congress who can say with confidence "I know for the banking industry as a whole in this Nation or in my State or any other particular segment what that real kind of cost data is."

If you are really going to seriously look at where interest rates ought to be, what will happen if you lift them or don't lift them and why, that is the kind of data you need to have.

Senator MITCHELL. You heard testimony early this morning from Mr. O'Connor and Mr. Fox, and you will hear later about what a hard time these companies are having.

Their costs are going up. Yet, they are bumping into these rate ceilings and need relief. They can't wait for a study.

What is your answer to that?

Mr. ERWIN. I think there are almost two different suggestions I would make on that.

First, I didn't hear anyone screaming in 1972 and 1973 and 1974 and 1975 when they may have been doing very well, thank you, under the State interest rate ceilings.

In my opinion, it is not the purpose of Government, particularly in regulating in any industry, to guarantee anybody a profit.

There is nothing holy that says profits today have to be the same they were back then. The fact that they lost money in January or February, my question is, how much did you make 5 years ago and let's look at the long picture before we start making decisions as to whether today's interest rate ceilings immediately need to be raised to respond to a specific short-term need.

The second answer, and perhaps I think the more fundamental answer, is in my experience, the State legislatures have not been nearly as unresponsive to the needs of the industry as they would perhaps portray.

I would like to think I am an effective consumer lobbyist in Annapolis, Md., but I can tell you the industry beats me down there more often than I would like to admit.

I have personally been involved in interest rate legislative issues in Annapolis, I think, darn near every single year for the past 7 or 8 years.

The legislature has granted increases in that time. With the exception of one or two States, I don't think that you can make a compelling case that the failure of the Federal Government to act today is going to result in the financial ruin of that industry.

The States have done pretty well at muddling through at regulating interest rates for almost 200 years now, and I suggest 1 more year won't make or break anybody.

The States do respond when they make a case.

Ms. ALEXANDER. Could I add to that? If you look at congressional debate surrounding recent preemptions adopted in 96221, you will find them replete with references to two States.

One is Arkansas, which has a constitutional prohibition on any rate greater than 10 percent. It was a devil of a problem for them there, but you would get the impression, reading that national law, that somehow the main purpose of it was to solve the problem for the two Senators from Arkansas on the floor of the Senate.

Senator MITCHELL. Both fine fellows.

Ms. ALEXANDER. Yes. No problems. It's just that it's incredible how often you will see reference to that State as the justification for the problem.

The other State that we are all paying the price for is the home of the big money center case in this country, New York.

They had a bloody battle there for the last year about raising interest rates for bank credit cards and because they couldn't get what they want there and haven't yet, they are coming to Congress to solve their problem.

To look at the real basis for need, you will have to look at the home States of a lot of these creditors to see what the problem really is.

Senator MITCHELL. Thank you very much.

Mr. ERWIN. Do you have any other questions?

Senator MITCHELL. No. Do you have any other comments?
Mr. ERWIN. No. Thank you very much.
[The complete statement follows:]

Testimony of
H. Robert Erwin, Jr.
Before the Consumer Affairs
Subcommittee of the Senate
Banking, Housing and Urban
Affairs Committee On
H.R. 7340 and a Consumer
Usury Study Commission

Mr. Chairman:

My name is H. Robert Erwin, Jr., and I am the Chief of the Consumer Protection Division of the Office of the Attorney General of Maryland. Prior to assuming my present position, I was employed for seven years at the Consumer Law Center of the Legal Aid Bureau, Inc., in Baltimore, Maryland. In both positions, in addition to representing consumers in legal actions, I have been extensively involved in representing consumers on a wide range of credit issues before the Maryland state legislature.

I appreciate the opportunity to appear before the Subcommittee today to testify on H.R. 7340, the Cash Discount Act, and on the need to establish a Consumer Usury Study Commission.

H.R. 7340

The experience of the last six years clearly indicates that existing efforts at both the Federal and state levels to encourage merchants to offer "discounts" to cash customers have

been unsuccessful. In 1972 the Maryland legislature enacted what is now Section 12-509 of the Commercial Law Article, Annotated Code of Maryland which states:

> Notwithstanding any agreement to the contrary between a seller and the issuer of a credit card, the seller is permitted to offer a cash discount to consumers who pay cash instead of using a credit card.

This provision of the Maryland Retail Credit Accounts Act became effective January 1, 1973. As you know, in 1974 Congress enacted Section 167 of the Fair Credit Billing Act in an attempt to accomplish the same purposes.

In spite of the statutes and the efforts of retired citizens groups and Consumers Union to have them implemented, very few merchants in Maryland have implemented a policy of offering "discounts" to cash customers. I personaly cannot name a single store in Maryland which has ever implemented such a policy; and, when I checked with the office of the Commissioner of Consumer Credit in Maryland, they confirmed that hardly anyone has taken advantage of these statutes. In short, existing efforts have been a failure.

Regardless of whether the card issuer negotiates a discount with the merchant for the purpose of recovering costs or

increasing profits, from the consumers' point of view (and in fact) it is money which ends up in the pocket of the card issuer rather than the merchant. Thus, common sense as well as economic theory dictate that the amount of this discount be viewed as a "cost" of extending credit and not a "cost" of the goods or services purchased. Although such discounts are now in the 1 to 2 percent range rather than the 5 to 6 percent range of eighteen months ago, the cash paying customer is "subsidizing" the credit customer. If consumers are to be encouraged to use credit wisely, it is important that they know the full costs associated with using credit and that such hidden subsidies are at least disclosed, if not eliminated. This is as true in 1980 as it was in 1972 or 1974.

Consequently, I support the efforts of this Congress embodied in H.R. 7340 to bring about the result which has thus far eluded us. The elimination of the arbitrary 5 percent ceiling on the amount of "discount" which can be offered to cash paying customers and the addition of a clarifying definition of "regular price" are clearly steps in the right direction. My only reservation is whether H.R. 7340 goes far enough to encourage merchants to offer cash discounts, particularly in the absence of clarifying amendments on the issue of surcharges.

If it is the Committee's intention that, by adding a definition of "regular price" to Section 103, the amount of the "discount" offered to cash customers will not result in a surcharge which violates Section 167(a)(2), at minimum that intention should be clearly stated in the Committee report.

Basically, it seems to me that the controversy about the discount-surcharge issue is largely one of semantics. If, indeed, the amount of the discount negotiated between the merchant and the card issuer is a "cost" of credit, as I believe it is, there ought to be a way of permitting cash paying customers to avoid that "cost" regardless of whether we label the amount of the differential a "discount" or a "surcharge."

The Need for a Consumer
Usury Study Commission

As a state official who has been actively involved at the state legislature on credit issues and interest rate regulation for the past 8 years, I am deeply concerned about any movement at the Federal level to preempt state usury statutes. I am aware from my own personal experience of the complexities of the trade-offs between interest rates, security and other creditor remedies, and the availability of consumer credit. As a consumer lobbyest at the state level, I have been intimately

involved in personally negotiating with industry representatives exactly these types of compromises. That experience has taught me the difficulty and delicacy of regulating interest rates in the public interest.

I think a few brief examples can best demonstrate the absolute necessity of accurate information when undertaking this task. For many years in Maryland, as in most states, it was common practice for loan companies to take a security interest in the household goods of the borrower. Thousands of loans were made in Maryland every year based on such security. It was not until I examined the statistics and noticed that the "security" was only foreclosed by all loan companies in Maryland one or two times per year, that I was fully able to document that this was really a false security interest which was only used as an "in terrorum" collection device. It could be prohibited by legislation without affecting interest rates. Maryland has now done this without an adverse affect on the industry.

A more subtle example relates to the "costs" of lending money. In Maryland, each separate loan company office is established as a separate corporation. Each is a wholly owned subsidiary of the parent corporation. The parent corporation

may also establish a separate national subsidiary set up for the purpose of borrowing large amounts of money and relending it to the local offices. Hence it becomes difficult, if not impossible, to determine the true "cost" of money to the local office since there may well be built-in (but undisclosed) "profits" in transactions between subsidiaries.

I have also found it extremely difficult to obtain any accurate data from the banking industry regarding levels or profitability of consumer lending activity. In the most recent session of the Maryland legislature, the banking industry in Maryland refused our requests that they compile and disclose aggregate data on such elementary questions as number of consumer loans made, dollar amounts of consumer loans outstanding, or the costs associated with such loans. These are but a few examples of the difficulties I have encountered in obtaining the type of data necessary to fully address the issues involved in interest rate regulation.

I believe that Congress would be making a grave error to address the issues of preemption of state usury laws without a full and careful study of all of the various ramifications of such a step. We need only to remember the events of the past six months regarding the administration's efforts to temporarily

restrict consumer credit to remind ourselves of the key role consumer credit plays in today's economy. Several major industries, such as the housing industry and the automotive industry, are heavily dependent on consumer credit. The ramifications to the nation's economy of a miscalculation regarding the results of Federal preemption of state usury laws could be very serious if not disastrous.

In the course of representing consumers over the past eight years, I have pesonally seen the personal impact the lack of credit can have in human terms. Particularly in low income neighborhoods of the inner city, welfare families virtually become "enslaved" to one or two merchants who initially extend them credit. Such families enter a never ending cycle of debt in trying to pay off relatively small amounts of credit at high interest rates. I have also personally seen the personal ruin which results from the bankruptcy of a middle income family due to their misuse of easily available credit. The loss of their home, automobiles, and sometimes even personal possessions can result in severe emotional, as well as economic damage to such a family. In short, the results of "too much" or "too little" credit in an economic sense can be extremely serious to both the nation's economy and, more importantly, to the personal lives of our country's citizens.

I strongly urge the Committee to adopt a proposal for a Consumer Usury Study Commission to ensure that you have the best available data, and to ensure that the advantages and disadvantages can be closely scrutinized, before making any final decision on proposals to preempt state usury laws.

Senator MITCHELL. I want to move along because I want to give everyone a chance to have their say. Thank you.

The next group of witnesses will be Mr. Hugh Smith, representing the American Express Co., Ms. Amy Topiel, vice president and counsel of the Interbank Card Association, and Mr. David Huemer, senior vice president, VISA-U.S.A.

You have been listening for the last half an hour. You ought to have a chance to have your say.

Mr. Smith, how are you today?

STATEMENTS OF HUGH SMITH, WASHINGTON REPRESENTATIVE, AMERICAN EXPRESS CO.; AMY TOPIEL, VICE PRESIDENT AND COUNSEL, INTERBANK CARD ASSOCIATION; AND DAVID HUEMER, SENIOR VICE PRESIDENT, VISA-U.S.A.

Mr. SMITH. Fine.

Senator MITCHELL. You can begin in any form you see fit. Proceed in any order the three of you decide.

I would ask you to summarize your statements, please, and the full statements will go in the record.

Mr. HUEMER. I will begin, Mr. Chairman.

My name is David A. Huemer, and I am senior vice president of VISA-U.S.A., for whom I am speaking today.

VISA is a nonstock membership corporation incorporated under the laws of the State of Delaware which administers the VISA card program within the United States.

The membership of the corporation is comprised of more than 11,000 commercial banks, savings banks, savings and loan associations, and credit unions which participate in the VISA program.

As of the end of 1979, the VISA blue, white, gold card was held by approximately 64 million individuals and accepted at more than 1,900,000 merchant outlets and 40,000 member offices throughout the country.

OPPOSED TO H.R. 7340

For the year 1979, total dollar volume of the VISA system in the United States exceeded $27 billion.

VISA is opposed to the enactment of H.R. 7340, which would remove the existing 5-percent limitation on cash discounts as well as any other law which would authorize the assessment by merchants of surcharges for transactions with respect to which payment is made by a credit card.

VISA has always believed the cash discount provisions of the Truth in Lending Act to be ill-conceived. We have consistently felt any discount offered by merchants to induce payment by cash instead of by a credit card, regardless of the amount of the discount, to be highly discriminatory against consumers who desire to purchase goods and services through the use of a bank card and inconsistent with the underlying purposes of the Truth in Lending Act.

Moreover, we have been concerned that such merchant discount subject issuers to the risk of violation of State usury laws.

Nothing which has occurred since the enactment of the existing provisions mitigated these concerns. We believe that congressional authorization for merchants to offer greater discounts or assess surcharges will greatly exacerbate them.

In summary, we believe that Congress made a serious mistake in passing section 167 and in providing the exemption that it did, even for the limited range of transactions encompassed by the existing cash discount language.

The extension of this provision to accommodate even greater discounts, and possibly the assessment of surcharges is, we submit, simply not justified.

We have also been asked to furnish our views concerning the establishment of a proposed consumer usury study commission.

VISA does not believe such commission to be either necessary or desirable. Rather, we believe the information sought by the commission is already well-known.

To the extent that existing usury ceilings preclude creditors from recouping their expenses and realizing a reasonable return, consumer credit will simply not be available.

We need only look back a couple of months to observe the adverse impact of such ceilings upon consumers and retail merchants.

We don't believe that studying the matter for an extended period will provide any additional insight. For example, VISA can document that as a result of the high cost of funds and restrictive State laws, the VISA system suffered a loss of over $71 million in the first quarter of 1980.

This was not a result of poor management or because of an inability to predict the day-to-day financial trends of the business.

These losses were suffered as a direct result of restrictive state laws and the explosive increase in the cost of funds.

Given the nature of the present economy, the situation could occur again at any time, we believe.

Senator MITCHELL. Mr. Erwin would like to have me ask you: Don't tell us about your losses in the past few months. Did you make money over the last 5 years?

Mr. HUEMER. Yes. The system made money in the last 5 years. In the first 5 years, it lost a considerable amount of money.

Senator MITCHELL. When the cost of money was 75 percent less than now, were you charging the maximum rate permissible in most States?

Mr. HUEMER. The rates charged by banks have always varied. In many States, they were charging up to the maximum rate.

It's fair to point out, however, that because of substantial startup costs, many financial institutions offering the product didn't recoup their initial expenses, initial cost, for up to 6 years.

You are not talking about unconscionable profit for a period of time. You are talking in many instances about recouping the fairly heavy startup costs of the business.

Such as establishing computer programs and issuing the cards to begin with and all of the front-end work done in order to establish a viable program.

Senator MITCHELL. Don't let me create the impression I am against business making a profit. I recognize that is the reason for their existence.

Mr. HUEMER. Thank you. We perceive the payment service provided by the bank card to consumers to be separate from the credit, which may or may not be used.

The fact that 40 percent of VISA cardholders in the system today don't use credit is a clear indication of the way the system is developing.

CREDIT CARD AS CASH SUBSTITUTE

Cardholders increasingly perceive the card as a cash substitute. Those who do use credit, however, should not continue to be forced to support the system for those who don't.

Senator MITCHELL. Those who take the cash discount say that cash customers are subsidizing the costs of credit.

Do you agree or disagree with that?

Mr. HUEMER. I disagree. I have yet to see any evidence that that is the case.

Senator MITCHELL. Well, a merchant has an item costing $100. He sells it for $100 to the fellow paying cash and the same for the fellow giving him a VISA credit card.

What is your merchant's discount now?

Mr. HUEMER. The nationwide average merchant discount is 2.10 percent, that's down from 2.64 percent 5 years earlier.

Senator MITCHELL. So, instead of getting $100, he gets $97.90 from VISA. He realizes $197.90 from the two transactions. You don't think an argument can be made the cash customer is subsidizing the cost of credit in that case?

Mr. HUEMER. Only if you exclude the cost of processing cash. And I believe there are costs in dealing with cash. There is accounting required to deal with cash.

There is the security required by merchants who deal heavily in cash.

Senator MITCHELL. Are you disregarding the fact he has the cash available on the day of the transaction and has the benefit of that money during the period of time between the transaction and the time he would ordinarily get the money from VISA? How long is that?

Mr. HUEMER. The money is generally available to the merchant as of the day of the deposit at his local merchant bank.

Senator MITCHELL. You have to explain that.

Mr. HUEMER. The merchant, in the normal course of business, takes his sales slips, perhaps on a daily basis, and bundles them up and carries them to his bank.

That constitutes his merchant deposit for those sales slips. The bank accepts those slips and then proceeds to process them.

Senator MITCHELL. So there is no time gap?

Mr. HUEMER. Generally no time gap. Perhaps a day.

Senator MITCHELL. That is a very incidental benefit, if any, the fact that he has the cash.

Mr. HUEMER. True, in fact immediate credit is perceived by many merchants to be a benefit of the bank card business.

If, however, the subcommittee desires to pursue the establishment of the Consumer Usury Study Commission, we believe the scope of the Commission's responsibility should be expanded to specifically include the impact of various State restrictions upon financial institutions to impose annual, monthly or other charges for the basic payment service offered through bank card as distinct and separate from usury limitations.

In addition, because of the relative importance of such national bank cards in relation to other forms of credit, we submit the Commission should include a representative of one of the two major bank card organizations.

Senator MITCHELL. You are against the Commission, but if we have to have one, you want to participate.

Mr. HUEMER. That's correct. The contribution which such a representative could make in carrying out the legislative mandate of the Commission would, we believe, be invaluable.

We also urge the subcommittee to shorten the period of time within which the Commission must submit its report. The suggested report date of December 1981 is too long a period to study matters that already received intensive study.

Senator MITCHELL. Do you intend to come before the next Congress and urge enactment of further preemptions State usury laws by the Congress?

Mr. HUEMER. We would support any such effort.

Senator MITCHELL. Could I ask, do I anticipate you will do the same?

Ms. TOPIEL. More than likely.

Mr. SMITH. The American Express Co. doesn't charge interest and is basically unaffected by the usury laws and would not be involved in such.

Senator MITCHELL. Would you support authority to impose transaction charges?

Mr. HUEMER. We would support a separation of the payment aspects of the card from the credit aspect of the card. That is, we would support Federal preemption of State limitations on charges for the card.

That proposal is contained, as a matter of fact, in exhibit 1 attached to our written testimony.

TRANSACTION CHARGES VERSUS SURCHARGES

Senator MITCHELL. Ms. Alexander made the statement that credit card companies will support transaction charges but they won't support surcharges, because they get the benefit of the former while the merchants get the benefit of the latter.

I want to give you a chance to respond to that. That either you don't support transaction charges, or, if you do, that it is presumably for some motive other than what she suggested.

I will ask each of you to respond. You should have a fair chance to answer a statement like that.

Mr. HUEMER. I would be pleased to respond. The cutting edge is that it was demonstrated, at least in the credit card business, that there is a substantial inequity which exists with respect to the basic fees which accrue to the providers of such service; namely, that the credit customer, the consumers who extend their balances, are supporting that 40 percent of cardholders who pay off the balance in full each month and use it as a convenience device.

Senator MITCHELL. After this I won't pay my American Express bill on time after today. I could move from the minority to the majority here. [Laughter.]

Go ahead.

Mr. HUEMER. With respect to the counterbalancing arguments on surcharges or discounts for cash, we believe the underlying assumption that there is an unfair cost burden associated with bank card transactions vis-a-vis cash or any other payment device is untrue and that mythical cost burden should not, in fact, be highlighted by Federal legislation. We don't believe the underpinning argument has been demonstrated to any extent that there is, in fact, an unfair cost burden associated with the bank card versus any other means of payment.

Senator MITCHELL. The question isn't whether it's an unfair cost burden. The question is whether there is a cost burden. I don't see how you can say you ought to be able to make a transaction charge, because each transaction costs you something, and yet to say that nobody else—that the merchant should not be able to impose a surcharge, because it doesn't cost them anything. It costs you something to handle the transaction. Doesn't it cost them something, including the discount rate?

Is Ms. Alexander wrong? Is your position inconsistent?

Mr. HUEMER. I believe she is wrong.

Senator MITCHELL. How about you?

Ms. TOPIEL. I would certainly confirm some of the things Mr. Huemer said, and I would point out further that with a transaction charge, the consumer is told up front that that would be the case, and those are the terms on which they accepted the credit.

When a surcharge is imposed, the consumer is not aware until he or she actually reaches the point of sale, that a surcharge may be imposed on that transaction.

Senator MITCHELL. Couldn't you take care of that by putting a sign on the window?

Ms. TOPIEL. No; because the consumer already made the assumption that the card they use in a store would be treated as any other payment device.

Senator MITCHELL. You could send a slip in the mail with the card, couldn't you?

Ms. TOPIEL. It is not for the creditor to disclose what the merchant will do, if the merchants are going to use that as some sort of ——

Senator MITCHELL. It seems to me that could be taken care of. You could notify them. I realize you wouldn't want to do it.

Ms. TOPIEL. We could not do it.

Senator MITCHELL. You couldn't put together a notice that said businesses which accept this credit card may under the law impose a surcharge, and you should be aware of that?

Ms. TOPIEL. Under truth-in-lending that wouldn't suffice.

Senator MITCHELL. Not specific.

Ms. TOPIEL. That's right.

Senator MITCHELL. Mr. Smith, what do you think about that? Do you think there is inconsistency in saying they favor transaction fees but not surcharges?

Mr. SMITH. We have consistently resisted the imposition of transaction charges and don't take any position on these versus surcharges. We do, however, believe it is not accurate to say that credit sales impose a cost on cash customers. I will elaborate on that in my statement.

Senator MITCHELL. You reject that assumption?

Mr. SMITH. Correct.

Mr. HUEMER. If I may, in the definition of transaction charges, I would also include annual fees for the card.

Senator MITCHELL. That's right. The way they are going up——

Mr. SMITH. Indeed.

Mr. HUEMER. Shall I continue?

Senator MITCHELL. Thank you very much, Mr. Huemer.

Ms. Topiel, would you care to summarize?

INTERBANK'S VIEWS OF STUDY

Ms. TOPIEL. Sure. You have asked for an expression of Interbank's views regarding the establishment of a commission to study the various issues raised by State usury laws. Although Interbank itself does not extend credit or participate in the credit decisions of its individual members, we are only too familiar with the turmoil imposed on our industry by the unrivaled spiraling of market rates which caught our members in a financial squeeze. They have had to pay between 13 and 20 percent for the money they lend, while archaic State interest rate ceilings placed a cap on the rate at which our members can lend this money.

Despite the fact that market rates have fallen in recent weeks, the threat of a repeat performance of the ill effects of inflation is very real to our members. Some of these institutions have not yet recovered from the ravages of a runaway economy.

Interbank supports any effort seeking to obtain relief for its members from the outdated and rigid usury laws. Recognition of the need to raise or eliminate State interest rate ceilings on consumer lending has increased. This past year we witnessed a flurry of legislative developments on the State level intended to alter the usury ceiling to enable the financial community to respond to the agitated economy.

Remedial action on the part of State legislators has been slow. For this reason, Interbank applauds the focus of attention this Congress has given to the study of usury laws in areas such as mortgage, business, mobile home and agricultural credit.

Senator MITCHELL. You think that should be extended across the board? Would you like to see all State usury laws preempted?

Ms. TOPIEL. We don't have easy answers and this is not a simple matter. We believe it's a matter of national concern and that is why Congress should definitely go forward with a study of it, but we are not totally opposed to additional review of that matter, so long as it comes to a speedy resolution.

Senator MITCHELL. Say that again. You are not opposed to the study. You just want the answers pretty soon, because you are hurting.

Ms. TOPIEL. Absolutely.

Senator MITCHELL. Is that fair?

Ms. TOPIEL. It is.

Senator MITCHELL. Are you bothered at all by the argument this has been an area that was left to the States, and here we have now the Federal Government getting into a whole new area that we ought not be in?

Ms. TOPIEL. I don't think this is a new area for the Federal Government. They have moved into this area regulating most aspects of the consumer credit relationship already. I think it makes sense to extend it at this time to the area of usury ceilings. More importantly, I think the——

Senator MITCHELL. If we took the position that every time the Federal Government gets into something at all, they ought to go all the way, we would need six new office buildings.

Ms. TOPIEL. We are talking about more than a toehold in a relationship. We are talking about a strong encompassing of the Federal Government in the credit relationship.

Mr. HUEMER. Mr. Chairman, if I may, please keep in mind we are dealing with a national product and not really a local product. Bank cards travel all over the world. The perspective of VISA, and I am sure Interbank, is that our job is to make that product effectively function the same to consumers worldwide. A consumer should have the same expectation in a store in Maine with respect to the way the transaction functions as he will if he walks into a store in Kuwait.

Senator MITCHELL. What about the argument raised by Ms. Alexander about enforcement? Do you think if the Federal Government preempts State usury laws and requires other compensating consumer protections that that ought to all be taken over by the Federal Government? You want to get the States out of the business of enforcement completely?

Ms. TOPIEL. I think that is exactly one of the questions we would like to see addressed. I am not suggesting that the prior law, in fact, ignored that as an issue, but there are real questions as to what can be done in this area, and it should be addressed.

We suggest that such an exposition demands the skills of experts, but unfortunately the proposed Commission, we think, is not structured to meet this task. Its proposed composition does not represent a broad perspective of views on the issues to be presented. It barely acknowledges the diverse structure of the financial industry and grants minimal representation to what we see as the community most affected by the study.

We suggest there are perhaps more expert, more efficient established vehicles available for such a project. For example, in the Depository Institutions Deregulation and Monetary Control Act, significant issues, such as these, were assigned to groups of Federal financial agencies for study and report. We suggest that these may be alternatives or that similarly composed groups serve the purpose.

If, however, the deadline for the Commission report would be set at March 1, 1981, and if the composition of the Commission better reflected the complexion of the financial community, we would be prepared to reconsider the proposal.

As it stands now, we fear more harm than good would come to our membership if the Commission were established.

You also asked for our views on H.R. 7340. We view this proposal as theoretically unsound. It assumes that merchants prefer to receive cash payment, that they are not presently receiving a significant portion of cash payments, and that merchants would pay more than 5 percent of the price of the items to receive cash.

We don't believe these assumptions are valid, yet we are confident in the quality of our service provided to consumers and merchants alike. We believe the credit card service has been successful, important and an efficient payment alternative and believe it will continue to be.

However, we suggest that a word of caution is important about the possibility that loosening the rules on cash discounts would open the door to encouraging credit card surcharges. Surcharges, in our view, unfairly penalize those consumers for whom credit cards represent a necessary and valued service. Surcharges would further financially burden those consumers with limited cash and who can least afford to pay these higher prices.

Therefore, we strongly urge that any action to advance H.R. 7340 be coupled with a permanent prohibition on surcharges.

Thank you for the opportunity to present our views.

Senator MITCHELL. Is it fair to say that you are for the prohibition of surcharges and against cash discounts, and you are for the prohibition more than you are against the discounts so that while you would find the prohibition intolerable, you could accept the cash discount as long as it were accompanied by a permanent prohibition on surcharges?

Ms. TOPIEL. To tell you the truth——

Senator MITCHELL. I hope you have been. It's dangerous to proceed a sentence with that. [Laughter.]

Ms. TOPIEL. We are most definitely opposed to the prohibition, to removing the prohibition on surcharges. We recognize, however, that the distinction between a cash discount and surcharge may not be so clear. In the way the Federal Reserve Board has set up the rules, we do not see any particular abuse in the area of cash discounts.

We would perceive, however, that if there were a removal of the surcharge prohibition, there would likely be abuse there. Although the distinction may not be too clear, and there probably are similarities, we certainly would like to see the prohibition on surcharges continued.

Senator MITCHELL. Thank you.

Mr. Smith? Would you summarize your statement? I know you better than I know the others. I can be harder on you. You have about 5 minutes.

Mr. SMITH. I will try and read fast.

First, I wish to elaborate on the reasons for our rejection of the premise that credit card sales are subsidized by cash sales. First, economies of scale apply to merchandising as elsewhere. The more sales a merchant has, the lower the unit cost and the greater his profits. Higher profits enhance his ability to compete and enable him to offer lower prices, therefore benefiting cash and credit customers equally.

IN-HOUSE CREDIT

Years ago, in a search for higher volumes, merchants found sales increased dramatically when they offered credit. Virtually every merchant at one time had his own in-house credit system. Again, because of the increased sales resulting from credit, lower prices could be offered to all customers, cash as well as credit.

In recent years, the costs of in-house credit—for instance, the cost of money, credit investigations, processing, postage, bad debt losses and collections—have become prohibitive for all but the largest merchants.

Credit and charge card issuers responded to the problem by devising a means to provide all the benefits of a credit system to the merchant more efficiently and cheaply than their in-house systems. Moreover, because of their national scope, credit cards provided an added bonus to the merchant, another source of increased sales.

Because many traveling cardholders live and shop outside the merchant's normal market area, they would not normally purchase from the merchant except for the fact he accepts a nationally known card.

Thus, the merchant benefits through both reduced costs and further increased sales. Again, these economies result in lower prices to all customers, cash as well as credit.

The bottom line to this is that it is essential for most merchants to offer credit in order to maximize sales. Far from getting a free ride at the expense of cash customers, credit card customers help to make a merchant's unit cost as low as possible and therefore contribute to lower prices for all customers.

Arguably, without the existence of efficient credit providers with the increased sales they provide, cash customers would be paying an even higher price. It is for these reasons that we reject the central premise that cash customers subsidize credit card users.

Further, I suggest that it is slightly misleading to take a look at one specific transaction. The merchant sets his prices based on his total sales expectations, taking into consideration all the factors I just discussed, including credit sales as well as cash sales and as well as all his other overhead items.

As I already noted, prices are thereby dampened by the increased volume and decreased credit cost provided by an efficient credit system. To look at a specific $100 transaction, cash versus credit, is after the fact of the pricing decisions made by the merchant which take into account all of these factors.

Another point made, but I would like to reiterate: cash sales are not cost free. For example, the following charges are solely attributable to cash transaction: bad check losses; debt collection; insurance for cash handling; bank fees for cash and check handling; increased employee fraud. In credit transactions, the costs are the card issuer's discount and funding for delayed payment should there be a substantial delayed payment.

When these costs are totaled and compared, the results are very close. Unfortunately, I do not have data for the United States on the comparison of cash sales versus credit sales, but we have a recent study conducted by our company in the United Kingdom, and we find that the cost of handling and using cash versus credit is very close indeed.

There are those who argue there is no difference between a discount for cash and surcharge for credit card use; that may be true from a theoretical or mathematical viewpoint, but there is a real difference in fact. If a merchant offers a cash discount, fine; it means a lower price to the shopping public.

But if a merchant imposes a surcharge, he is simply taxing the credit card user, and the cash customer does not save a cent. That is higher prices for the public at no discernible benefit.

Further, surcharge systems are potentially discriminatory. They provide an easy technique for a merchant to use to penalize some customers for the sake of added profits without passing on a benefit to others.

The reason is simple. The credit card customer is often the type of person from whom a small extra profit can be extracted at no risk to the merchant, but with potentially serious effects to the card issuer. The merchant has no incentive to minimize the surcharge. It is extra profit to him.

Aside from its obvious impact on the credit card user, the surcharge poses a real threat to the card issuer because excessive charges can destroy the card issuer's good will, which is essential to the functioning of a credit card system. This good will may be of minimal importance to one single merchant, but the actions of a small number of such merchants can have a dramatic effect on the total system.

The reason why the merchant can successfully impose a discriminatory price on cardholders is clear. In economic terms, a cardholder's demand for a particular product at a particular time may be more inelastic than a cash customer. He may be out of town without cash or easy access to his checking account. He may need to extend payment for a short period of time until cash is available. He may only be able to purchase on credit since he may not be wealthy enough to pay cash for everything he needs.

For any of these and other reasons, he may not be able to switch to cash to avoid the surcharge. If the customer comes from out of town, the merchant may not care whether he attracts return business from that customer. For all these reasons, the credit card customer is a ready target for discriminatory pricing practices.

The surcharge can be extracted, and those without a ready supply of cash will be the victims of discriminatory pricing at the expense of those who always pay in cash. Surcharge systems are potentially deceptive as well. A credit card customer, whether or not he has cash in his pocket, can be attracted to a place by the low price on the window or knowledge of competitive prices. Once entering, he discovers he was misled because the price for him is more.

In addition, if the cardholder is switched to cash, the merchant succeeded in trading on the card issuer's good will for free. In short, the arguments for surcharge rest on superficial and incorrect assumptions and could prove unfair and discriminatory.

HISTORY OF SURCHARGE

I think a word about the history of the surcharge is appropriate at this time. Originally, in 1975, the ban was enacted for 3 years in order to give Congress time to study the issue. No study took place. In 1978, the surcharge ban was extended for another 2 years, again, ostensibly to provide additional time for study. Again no study was undertaken.

The ban will now expire in February 1981 unless it is extended.

We believe that the ban has worked well for the past 5 years. It has broad support in the business and consumer community. We believe the surcharge ban should not be permitted to simply lapse and the policy behind the surcharge ban effectively reversed, without concrete findings which support such a change.

Let me address the issues of cash discounts, generally and 7340, specifically. As we stated earlier, at the very heart of the discount surcharge issue is the premise that the discount paid by the merchant to the card issuer is a direct, additional and irrecoverable cost to the merchant.

From this premise, it follows that such a cost is necessarily passed along by the merchant to all consumers resulting in higher costs. For the reasons I already enumerated, we strongly dispute this premise. Nevertheless, we support the concept of cash discounts not because we believe they cure some particular inequity, but because they do result, at least superficially, in lower consumer prices.

We, therefore, continue to support the provisions of the Truth in Lending Act, which permit a merchant to offer cash discounts. H.R. 7340 would alter those provisions in two respects. First, it would eliminate the 5-percent ceiling and permit unlimited discounts. Second, it would substantially reduce the safeguards in the Act which require merchants to offer cash discounts to all prospective buyers and disclose the availability of cash discounts clearly and conspicuously.

As to eliminating the 5-percent ceiling on discounts, we certainly have no philosophical objection, although we question why a merchant would offer a discount greater than the discount he pays to a credit card issuer if it is an attempt to offset credit card costs.

In most cases the merchant discount is in the 2- to 3-percent range. Far less than the 5 percent now permitted under the existing law.

With unlimited discounts, there is the danger an unscrupulous merchant would offer eye-opening cash discounts of 25 or 30 percent in an apparent bargain, only to mask prices which end up being too high.

Thus, we are concerned that virtually unlimited discounts might be an invitation to abuse. Nevertheless, having stated these philosophical concerns and noting the inconsistency of discounts since credit does not result in increased prices, we do not oppose repeal of the 5-percent ceiling on cash discounts.

ABSENCE OF EFFECTIVE NOTICES

More troubling to us, however, is the absence of effective notice safeguards such as those now contained in the act. These provisions require conspicuous posting of a merchant's policy to insure that all customers are offered cash discount.

In contrast, H.R. 7340 would simply require a seller "make known" the availability of cash discounts without specifying how or to whom. While eliminating unnecessary paperwork is desirable, we see this change as seriously undermining the objectives of the bill. Because H.R. 7340 would no longer require posting, there is the very real potential danger a merchant would offer a cash discount to a credit card customer to induce him to switch to cash,

but remain silent for the cash customer and let him pay the full price.

That is not only unfair to consumers, but is contrary to the act's stated purpose. In addition, eliminating the current posting requirement and substituting the vague requirement that the merchant simply make known his policy is virtually unenforceable. It is an open invitation for the offending merchant to claim he did tell the cash-paying customer of this policy when he did not.

One simple solution is to require a sign on the cash register announcing the policy. That is exactly what the act now requires. To the extent that the act or its regulations may require more of the merchant than this, then these requirements could and should be relaxed. But we think it is essential that notice to all customers be explicitly mandated in any amendment to the existing rules concerning cash discounts.

We support cash discounts, but think H.R. 7340 is in need of tightening, particularly in the area of notice to the consumer.

Thank you very much, Mr. Chairman.

Senator MITCHELL. Thank you, Mr. Smith. Thank you very much, Ms. Topiel and Mr. Huemer. I appreciate your remarks.

[The complete statements follow:]

STATEMENT OF HUGH H. SMITH

AMERICAN EXPRESS COMPANY

JULY 24, 1980

Good morning, Mr. Chairman. My name is Hugh H. Smith, and I am Washington Representative of the American Express Company. I appreciate the opportunity to testify before the Subcommittee this morning on the issues of cash discounts, credit card surcharges, and preemption of state usury laws.

As you probably know, Mr. Chairman, American Express is the worldwide issuer of the American Express Card, a pay-as-you-go charge card. Because of our extensive worldwide involvement with this business for the past 21 years, we have a very direct interest in the issues of discounts and surcharges and, we believe, a good understanding of the economics of this business.

First, let me preface my discussion of the issue of surcharges with some basic facts of retailing:

1) Economies of scale apply to merchandising. That is, the more sales a merchant has, the lower his unit cost, and therefore the greater his profit. Higher profits enhance a merchant's ability to compete and enable him to offer lower prices -- therefore benefitting cash and credit customers equally.

2) Years ago, merchants found that sales increased dramatically if they offered credit. Therefore, virtually every merchant had his own in-house credit system. Again, because of the increased sales resulting from credit, lower prices could be offered to all customers - cash as well as credit.

3) In recent years, the costs of in-house credit (i.e., the cost of money, credit investigations, processing, postage, bad debt losses, and collections) have become increasingly prohibitive for all but the largest merchants. Credit and charge card issuers responded by devising a means to provide all the benefits of a credit system to the merchant more efficiently and cheaply than in-house systems. Moreover, because of their national scope, credit cards provide an added bonus to the merchant -- another source of increased sales. Because many traveling card holders live and shop outside the merchant's normal market area, they would not normally purchase from the merchant except for the fact that he accepts a nationally known card. Thus, the merchant benefits through (1) reduced costs, and (2) further increased sales. Again, these economies result in lower prices to all customers -- cash as well as credit.

4) The bottom line to all this is that it is essential for most merchants to offer credit. Far from getting a free ride at the expense of cash customers, credit card customers help to keep a merchant's unit costs as low as possible and therefore contribute to lower prices for all customers. Arguably, without the existence of efficient credit providers with the increased sales they provide, cash customers would be paying an even higher price.

It is for these reasons that we reject the central premise behind the arguments for surcharges -- that the discount paid to a card issuer is a direct, additional, and irrecoverable cost to merchants which is passed along to all customers in the form of higher prices. It is superficial and fallacious. We know it is not supported by empirical data.

Further, I submit that it is misleading to examine one specific transaction. The merchant sets his prices based on his total sales expectations, taking into consideration all of the factors I have discussed above, as well as his other overhead items. As I have already noted, prices are thereby dampened by the increased volume and decreased credit cost provided by an efficient credit system.

Let me emphasize that when one totals up the direct costs to the merchant solely attributable to cash sales and compares them with the credit card costs, they are very close indeed.

For example, the following charges are solely attributable to cash transactions:

- Bad check losses
- Debt collection
- Insurance for cash handling
- Bank fees for cash and check handling
- Increased employee fraud.

In credit card transactions, the costs are:

- The card issuer's discount; and
- Funding for delayed payment.

When these costs are totalled, the results are very close. But most important, these costs do not take into account the savings to a merchant from the increased volume resulting from credit card sales.

There are those who argue that there is really no difference between a discount for cash and a surcharge for credit card use. That may be true from a strictly theoretical or mathematical viewpoint. But there's a very real difference in fact. If a merchant offers a cash discount, that's fine because it means lower prices for the public. But if a merchant imposes a surcharge, he simply taxes the credit card user and the cash customer doesn't save a cent. That's higher prices for the public for no discernible benefit.

Surcharge systems are potentially discriminatory as well. They provide an easy technique for a merchant to use to penalize some of his customers for the sake of added profits, without passing any benefit on to others. The reason is simple - the credit card customer is often the type of person from whom a small extra profit can easily be extracted at no risk to the merchant - but with potentially serious effects on the card issuer. The merchant has no incentive to minimize the surcharge; it is all extra profit to him. Aside from its obvious impact on the credit card user, the surcharge poses a real threat to the card issuer because excessive charges can destroy the cardholder's good will which is essential to the functioning of a credit card system. This good will may be of minimal importance to one single merchant. But the actions of a small number of such merchants can have a dramatic effect.

The reason why the merchant can successfully impose a discriminatory price on cardholders is clear. In economic terms, a cardholder's demand for a particular product at a particular time may be more inelastic than a cash customer's. He may be out of town without cash in his pocket, or without easy access to his checking account. He may simply need to extend payment for a short period of time until cash is available. Or, as may commonly happen, he may only be able to purchase on credit, since he may not be wealthy enough to be able to pay cash for everything he needs. For any of these and other reasons, he may not be able to switch to cash to avoid the surcharge. And, if the customer comes from out of town the merchant may not care whether he attracts return business from that customer. For all these reasons, the credit card customer is a ready target for discriminatory pricing practices. The surcharge can be extracted, and those without ready supplies of cash will be the victims of discriminatory pricing at the expense of those who can always pay in cash.

Surcharge systems are potentially deceptive as well. A credit card customer, whether or not he has cash in his pocket, can be attracted into a place by the low price in the window, or simply by his knowledge of competitive prices. Once he

enters, he will discover that he has been mislead because the price for him is more. In addition, if the cardholder is "switched" to cash, the merchant has succeeded in trading on the card issuer's good will for free.

In short, the arguments for surcharges rest on a superficial and incorrect assumption, and surcharges in practice would be both unfair and discriminatory.

I think a word about the history of the surcharge ban is appropriate. Originally, in 1976, the ban was enacted for 3 years only, in order to give Congress time to study this issue carefully. No study ever took place. In 1978, the surcharge ban was extended for another 2 years, ostensibly to provide additional time for study, but again no study was undertaken. The ban will now expire in February, 1981 unless it is extended.

We believe that the surcharge ban has worked well for the past five years. It has very broad support in both the business and consumer community. We believe the surcharge ban should not be permitted to simply lapse, and the policy behind the surcharge ban effectively reversed, without concrete findings which support such a change.

Now, let me address the issues of cash discounts generally and H.R. 7340 specifically. As I stated earlier, at the very heart of the discount/surcharge issue is the premise that the discount paid by the merchant to a card issuer is a direct, additional, and irrecoverable cost to the merchant. From this premise it follows that such a cost is necessarily passed along by the merchant to the consumer, resulting in higher costs. For reasons which I have already enumerated, we strongly dispute this premise.

Nonetheless we support the concept of cash discounts on the ground that such discounts, if they are offered, are beneficial because they result in lower consumer prices. We therefore continue to support the provisions of the Truth in Lending Act which permit a merchant to offer cash discounts.

H.R. 7340 would alter those provisions in two respects: (1) it would eliminate the 5% ceiling and permit unlimited discounts; and (2) it would substantially reduce the safeguards in the Act which require merchants to offer cash discounts to all prospective buyers and to disclose the availability of cash discounts clearly and conspiciously. As to eliminating the 5% ceiling on discounts, we certainly have no philosophical

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objection, although we question why a merchant would offer a discount greater than the discount he pays to a credit card issuer. In most cases, this discount is in the 2-3% range, less than the 5% now permitted. With unlimited discounts, there is the danger that an unscrupulous merchant would offer eye-opening cash discounts of, say, 25%-30% in an apparent bargain, only to mask prices which end up being too high. Thus, we are concerned that virtually unlimited discounts might be an invitation to abuse. Nevertheless, having stated those philosophical concerns -- and noting the inconsistency of discounts, since credit does not result in increased prices -- we do not oppose the removal of the 5% ceiling on cash discounts.

More troubling to us, however, is the absence of effective notice safeguards such as those now contained in the Act. These provisions require conspicuous posting of a merchant's policy to ensure that all customers are offered cash discounts. In contrast, H.R. 7340 would simply require that a seller "make known" the availability of cash discounts without specifying how. While eliminating unnecessary paperwork is desirable, we see this change as seriously undermining the objectives of the bill. Because H.R. 7340 would no longer

require posting, there is the very real potential danger that a merchant would offer a cash discount to a credit card customer to induce him to switch to cash, but remain silent for the cash customer and let him pay the full price. That's not only unfair to consumers -- it's contrary to the Act's stated purpose. In addition, eliminating the current posting requirement and substituting the vague requirement that the merchant simply "make known" his policy is virtually unenforceable. It's an open invitation for the offending merchant to claim that he did tell the cash-paying customer of his policy when, in fact, he didn't. One simple solution is to require a sign on the cash register announcing the merchant's policy -- exactly what the Act now requires. To the extent that the Act on its regulations may require more of the merchant, then these requirements should be relaxed. But we think it essential that notice to all customers be explicitly mandated.

In summary, we support cash discounts but we think H.R. 7340 is in need of tightening, particularly in the area of notice to consumers.

Finally, I would like to address briefly the proposal to create a national commission to study federal pre-emption of state usury laws. (I should point out again that the American Express Card is a pay-as-you-go card, and since we do not lend money or charge interest, we are not directly affected by state usury laws.) Federal preemption is a very bold proposal and one, if enacted, which would have a potentially critical impact on the public. We believe that -- merits aside -- such a drastic step would be politically impossible to accomplish unless the fullest input from lenders, consumers, and state and federal regulators is received. Accordingly, we believe the Commission is a good idea and we support it.

That concludes my statement and I would welcome questions.

STATEMENT OF INTERBANK CARD ASSOCIATION
BEFORE THE SUBCOMMITTEE ON CONSUMER AFFAIRS
OF THE SENATE COMMITTEE ON BANKING, HOUSING AND
URBAN AFFAIRS

July 24, 1980

Good day, my name is Amy Topiel. I am Vice President and Counsel of the Interbank Card Association whom I am representing today.

Interbank is a membership corporation comprised of more than 12,000 financial institutions which issue and honor the familiar Master Charge and MasterCard service marks in connection with a credit card program.

Each of the participating Interbank institutions operates its own credit card program, makes its own credit decisions and sets its own policies in order to respond to and balance the ever-changing pressure of market and legal demands against the needs of its customers. Each institution sets its policies, of necesssity, taking into account the state-enacted usury ceilings and other unique state laws adopted in those states in which it operates.

You have asked for an expression of Interbank's views regarding the establishment a Commission to study the various issues raised by state usury laws.

Although Interbank, itself, does not extend credit nor participate in the credit decisions of its individual members, unhappily we are only too familiar with the turmoil imposed on our industry by the unrivaled spiraling of market rates which caught our members in a financial squeeze. They have had to pay between 13% and 20% for the money they lend while archaic state interest rate ceilings have placed a cap on the rate at which our members can lend this money. This interest limit ranged between 12% and 18%. A simple arithmetic calculation of the cost of money, alone, versus the interest rate return baldly demonstrates the problems our member banks have faced in meeting their expenses. Our members are profit oriented organizations which can only lend money at a reasonable rate of return to exceed their expenses. Under such circumstances, most institutions are forced to curtail their lendings. When regulated markets are choked into limiting business, an individual's alternative source of funds usually becomes the unscrupulous lender. In this way, usury ceilings adopted to protect individuals against unscrupulous lenders may, in times of high market interest rates, produce opposite results. Consequently, both industry and potential borrowers are handicapped in the pursuit of their respective affairs.

Despite the fact that market rates have fallen in recent weeks, the threat of a repeat performance of the ill effects of inflation is very real to our members. Some of these institutions

have not yet recovered from the ravages of a runaway economy. For this reason, Interbank supports any effort that seeks to obtain relief for our members from the outdated and rigid usury laws.

Recognition of the need to raise or eliminate state interest rate ceilings on consumer lending has increased. This past year, we have witnessed a flurry of legislative developments on the state level intended to alter the usury ceilings to enable the financial community to respond to an agitated economy, such as we have just experienced. Remedial action on the part of state legislators, however, has been slow and, in most cases, inert. Many state bodies meet only for short time periods, and, state legislative positions are often part-time posts so that even the most dedicated legislator can not devote his or her full time to state legislative matters. Despite the marked recognition of the issue it is not suprising, given the nature of the state legislative process, that few states were able to effect any substantive change in their laws.

For this reason, Interbank applauds the focus of attention this Congress has given to the study of state usury laws in the areas of mortgage, business, mobile home and agricultural credit. For like reasons, Interbank supports and encourages the focus of Congress' attention on consumer credit rate restrictions.

However, we do not consider the suggested commission to offer the best assistance to Congress in its deliberations.

The proposal to establish a commission to study consumer credit usury laws and to help Congress address the topic may have been an appropriate approach to this issue if time were not of the essence. But, it is. For many of our members the study commission proposed today is too late in coming. If a commission is established, it will likely delay other efforts to change usury rates at both the state and federal level and would only serve to forestall much needed action by government. For Interbank's members seriously suffering from the oppression of unyielding state usury laws, the establishment of the proposed commission cannot be patiently tolerated. The report, to be delivered by the commission, is slated for December 31, 1981. Our members simply cannot hold their breath for a year and a half, waiting for the report to be readied. We see no reason to permit our members to languish under these conditions until January of 1982 with no concrete promise of relief.

At the same time and without belittling the very real and grave concerns of these members, we perceive the override of state usury laws and its impact to be no simple matter. We recognize that some additional study of these matters may be warranted to ensure that all issues have been fully explored and

resolved. Such an exposition demands the skills of experts. Here again, the proposed commission is not structured to meet the task. Its proposed composition does not represent a broad perspective of views on the issues to be presented. The commission membership barely acknowledges the diverse structure of the financial industry and grants minimal representation to the community most affected by the study. The commission would be charged to study complex banking and lending issues which can not be learned overnight. Yet, none of the four individuals to be named for service are required to have any background or training in consumer finance matters or in the area of lending. Of necessity, the individuals sitting on the commission must have a respectable understanding of the machinations of the economic market and their affects on consumer credit.

Perhaps, there are more expert, more efficient established vehicles available for such a project. For example, in the Depository Institutions Deregulation and Monetary Control Act, significant issues were assigned to groups of federal financial agencies for study and review. We suggest that these or similarly composed groups should be considered as an alternative to the instant proposal. Or, Interbank would be pleased to reconsider the proposal if the deadline for the commission report would be unalterably set at March 1, 1981 and if the composition of the

commission better reflected the complexion of the financial community. However, as it now stands we fear that more harm than good would come to our membership if a commission were established.

* * *

You have also asked for Interbank's views on H.R.7340. Present law encourages cash discounts of up to 5% by excluding them from finance charge calculations. H.R.7340 would remove this 5% limit.

Interbank views this proposal as theoretically unsound because it assumes that merchants prefer to receive cash payment, that they are not presently receiving a significant portion of cash payments, and that merchants would pay more than 5% of the price of their items to receive cash.

We do not believe these assumptions are valid. Interbank is confident in the quality of the credit card service provided to consumers and merchants alike. The service has been a successful, important and efficient payment alternative and Interbank believes it will continue to be, whether or not the law on cash discounts is amended.

However, a word of caution is in order about the possibility that loosening the rules on cash discounts would open the door to encouraging credit card surcharges. Presently, the

law disallows a merchant from adding on a charge for credit card purchases, and properly so. However, the prohibition on credit card surcharges expires February 27, 1981. Surcharges would unfairly penalize those consumers for whom credit cards represent a valuable necessary service. Surcharges would further financially burden those consumers who have limited cash and who can least afford to pay higher prices. Accordingly, we strongly urge that any action to advance H.R.7340 be coupled with a permanent prohibition on credit card surcharges. In fact, we submit, the continuation of this prohibition should be made permanent regardless of any change in the law on cash discounts.

On behalf of Interbank, I thank you for the opportunity to express our views. If there are any questions I will be pleased to respond, if I can. If I cannot, I will be pleased to furnish answers after the close of the hearings.

STATEMENT OF DAVID A. HUEMER

ON BEHALF OF VISA U.S.A. INC.

Good morning. My name is David A. Huemer. I am Senior Vice President of Visa U.S.A. Inc. for whom I am speaking today.

Visa is a non-stock membership corporation incorporated under the laws of the State of Delaware, which administers the Visa Card Program within the United States. The membership of the corporation is comprised of more than 11,000 commercial banks, savings banks, savings and loan associations, and credit unions which participate in the Visa Program. As of the end of 1979, the Visa "Blue, White and Gold" card was held by approximately 64,000,000 individuals and accepted at more than 1,900,000 merchant outlets and 40,000 member offices throughout the country. For the year 1979, total dollar volume of the Visa System in the United States exceeded $27 billion.

Visa is opposed to the enactment of HR 7340 which would remove the existing 5 percent limitation on cash discounts, as well as any other law which would authorize the assessment by merchants of surcharges for transactions with respect to which payment is made by a credit card.

Visa has always believed the cash discount provisions of the Truth-in-Lending Act to be ill-conceived. We have consistently felt any discount offered by merchants to induce payment by cash instead of by a credit card, regardless of the amount of the discount, to be highly discriminatory against consumers who desire to purchase goods and services through the use of a credit card, and inconsistent with the underlying purposes of the Truth-in-Lending Act. Moreover, we have been concerned that such merchant discounts subject issuers to the risk of violation of state usury laws. Nothing which has occurred since the enactment of the existing provisions

has mitigated these concerns. Indeed, we believe that Congressional authorization for merchants to offer greater discounts or assess surcharges will greatly exacerbate them.

The present cash discount provisions were enacted for the purpose of enabling merchants to impose upon consumers who use bank cards, rather than cash, the perceived additional expense incurred by the merchant in offering this service. At the time the bill was being considered, Visa believed that the "cash discount" concept was predicated on a misunderstanding of the advantages that bank cards provide both merchants and retail customers. We believed that the underlying assumption that the cost to merchants of accepting bank cards was higher than the costs associated with other methods of payment and that these costs were being improperly passed on to the merchant's entire customer base was erroneous. We still believe the premise to be incorrect. Since the enactment of the current cash discount provisions, no evidence has come to our attention to substantiate this theory. To the contrary, given the continuing broad-based acceptance by merchants of bank cards, we do not believe that participation by merchants in bank card programs increases merchants' costs. Indeed, we feel that the reluctance of merchants to offer such discounts as are presently authorized confirms our belief.

The Subcommittee is considering the elimination of the present 5 percent limitation on cash discounts, as well as authorization for the assessment of surcharges. No longer is there even a pretense that the amount of such discount or surcharge be associated with the perceived costs to merchants of participating in a bank card system. Furthermore, by removing the Federal Reserve Board's implementing and interpretive authority, there

will no longer even exist a mechanism to assure that such discounts or surcharges will be offered to all prospective customers or that their availability even be disclosed. The bill would merely sanction the arbitrary discrimination by merchants against a significant segment of the consumer base, and potentially render unavailable to those consumers unable to pay cash a broad spectrum of goods and services. We simply do not believe there exists any justification for such legislation.

Visa is also troubled by the inherent inconsistency of HR 7340 with the underlying purposes of the Truth-in-Lending Act. The purpose of the Act is clearly set forth in Section 102 as "assuring a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various terms available to him and avoid the uninformed use of credit." Great weight has been given to this purpose by the courts in interpreting the Act. Substantial expense has been incurred by institutions which issue bank cards in complying with this mandate, and the penalties for violations are severe.

By excluding from the term "finance charge" charges imposed by merchants upon credit card users, the Congress has already circumvented the purposes which the Truth-in-Lending Act was intended to promote. By authorizing the assessment of unlimited charges by merchants, the reasons for maintaining the numerous, complex disclosure requirements which are imposed by the Truth-in-Lending Act upon open-end creditors become even more obscure.

Consumers utilizing open-end credit plans in their shopping activity presently know, in advance of their entering a business establishment, the approximate cost of the credit for any purchase they may be contemplating. This information is furnished them monthly by the issuer of their

credit card. HR 7340 would effectively deprive consumers of any meaningful information that would allow them to determine, prior to the time of purchase, whether to purchase an item by cash, by the use of a bank card, to obtain a loan pursuant to the cash advance feature of the bank card, to finance the purchase with a loan from an independent third party, or to obtain credit from the merchant.

After having traveled to a merchant location, seeing the decals of the various card plans on the door, and after having spent time selecting a product, the cash register is not the place at which the consumer ought to be first notified that the method by which he anticipated paying for the product has considerably greater expense attached to it than other methods of payment. Media could advertise a product for $600, but a consumer who traveled to the store anticipating purchasing the product utilizing his credit card could find, for the first time upon arrival, that the price for him is not $600, but rather $650 or more. In fact, the amount of the premium assessed by the merchant could often exceed the total finance charge imposed by the credit card issuer for the same purpose. Such merchant-imposed hidden charges are precisely the type to which the Truth-in-Lending Act was directed.

The imposition by merchants of premiums on credit card users also presents the serious issue of possible violations of State usury laws. These statutes in their many forms fix the maximum rate at which finance charges may be collected from the consumer. Pursuant to many of these laws, for the purpose of calculating finance charges, the price of goods is the price for which the seller would sell to the buyer if the sale were for cash.

The usury issue may arise in a number of different contexts. A purchaser might allege, for example, that a premium or discount imposed by a seller should be aggregated with the finance charge imposed by the card issuer to produce a total finance charge in excess of that allowed by State usury restrictions. If the sales price of the item indicated on the sales slip is the higher credit card price, which includes the premium imposed by the seller, and the card issuer computes its finance charge at or near the maximum rate allowed by State law on this higher price, the purchaser might also allege that the card issuer's finance charge alone is usurious, even without aggregating it with the seller's charge, because the card issuer's finance charge should only have been imposed on the lower cash price for the item.

A purchaser might also claim that the card issuer is violating a State statute that prohibits compounding of interest, since the card issuer's finance charge is applied to the credit card sales price, a portion of which results from a hidden charge imposed by the seller. The situation is further complicated because of the interstate nature of a high portion of bank card transactions and the unpredictability of the interrelationship and applicability of State law when more than one state is involved.

The vulnerability of card issuers to litigation, attempting to charge them with violations of State usury laws, even under existing law, seems particularly unconscionable when one realizes that the card issuer can do nothing to protect either itself or the public. An extension of the scope of the Act to remove the 5 percent limitation on discounts and allow the assessment of surcharges can only worsen the situation. Unfortunately,

Congress did not focus on these serious issues during its initial deliberations.

In summary, we believe that Congress made a serious mistake in passing Section 167 and in providing the exemption it did, even for the limited range of transactions encompassed by the existing cash discount language. The extension of this provision to accommodate even greater discounts, and possibly the assessment of surcharges, is, we submit, simply not justified. These merchant-imposed charges are not in the consumer's interests; they are, in reality, an attempt to shift unfairly the cost of a service which provides generally lower prices and more efficient business practices to one segment of the consumer public - the credit card user.

We have also been requested to furnish our views concerning the establishment of a proposed Consumer Usury Study Commission. Visa does not believe such a Commission to be either necessary or desirable. Rather, we believe the information sought by the Commission is already well known.

To the extent that existing usury ceilings preclude creditors from recouping their expenses and realizing a reasonable return, consumer credit will simply not be available. We need only look back a couple of months to observe the adverse impact of such ceilings upon consumers and retail merchants (see Exhibit A). We do not believe that studying the matter for an extended period will provide any additional insight. For example, Visa can document that as a result of the high cost of funds and restrictive state laws, the Visa system suffered a loss of over $71 million in the first quarter of 1980. This was not a result of poor management or because of an

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inability to predict the day-to-day financial trends in the business. These losses were suffered as a direct result of restrictive state laws and the explosive increase in the cost of funds. Given the volatile nature of the present economy this situation could occur again at any time. Is anyone willing to predict today that the prime rate and the cost of funds will not go through the roof again in six months? The Federal Reserve Board also has information in hand documenting this situation for bank cards as it has on automobile loans and the availability of mortgage money or other aspects of the credit economy. Addressing the problems facing the bank card business we believe that the ability to charge periodic and/or transaction fees on the basic service provided by the transaction devices being issued by financial institutions is the mechanism that will continue the availability of that service. (For a possible legislative solution to this problem, see Exhibit 2.) We perceive the payment service provided by the bank card to consumers to be separate from the credit which may or may not be used. The fact that 40 percent of Visa cardholders in the system today do not use credit is a clear indication of the way the system is developing - cardholders increasingly perceive the card as a cash substitute. Those who do use credit, however, should not continue to support the system for those who do not.

We would further like to suggest that existing entities in the Federal government could well develop the data needed by the Congress. For example, the Depository Institutions Deregulation Committee or The Interagency Task Force on Thrift Institutions, or both.

If, however, the Subcommittee desires to pursue the establishment of the Consumer Usury Study Commission, we believe that the scope of the Commission's

responsibility should be expanded to specifically include the impact of various state restrictions upon financial institutions to impose annual, monthly, or other charges for the basic payment service offered through bank cards, as distinct and separate from usury limitations. In addition, because of the relative importance of such national bank cards in relation to other forms of credit, we submit that the Commission should include a representative of one of the two major bank card organizations. The contribution which such a representative could make in carrying out the legislative mandate of the Commission would, we believe, be invaluable. We would also urge the Subcommittee to shorten the period of time within which the Commission must submit its report. The suggested report date of December, 1981, is simply too long a period to study matters which have already received such intensive study and which must be addressed promptly. In this regard, we would suggest that the Commission be required to submit its report not later than March 31, 1981.

On behalf of Visa, I would like to thank you for the opportunity to express our views. If there are any questions, I would be pleased to respond.

EXHIBIT 1

CREDIT CONTROLS AND BANK CARDS

ANALYSIS AND PROPOSAL

VISA U.S.A. Inc.
MARCH 1980

VISA SYSTEM

- Visa International is owned by over 12,000 member financial institutions headquartered in 76 countries. In 1979, 140 new members in 41 countries joined. Ninety million cards have been issued. Consumers use these cards to access checking accounts, savings accounts, investments, and lines of credit.

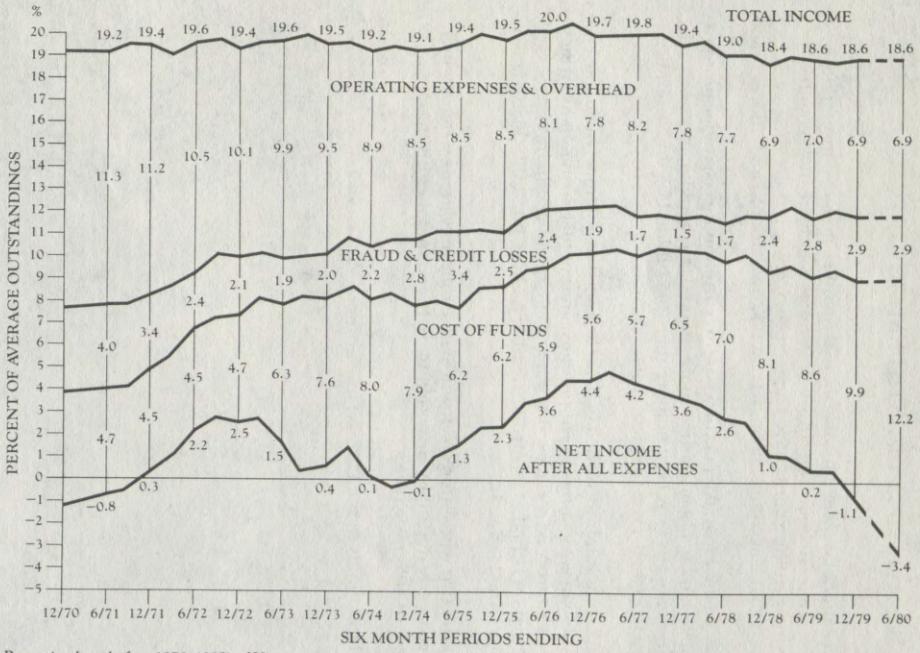
  Cards may be used to make purchases at three million merchant locations in 130 countries and to obtain cash at more than 60,000 banking offices. Volume increased 21% in 1979 to more than $35 billion U.S. In November, 1979, Visa launched a worldwide travelers cheque.

- Visa U.S.A. Inc. is jointly owned by U.S. financial institutions, including banks, savings and loan associations, credit unions, and mutual savings banks which offer one or more Visa services. It holds a single membership in Visa International on behalf of its owner members. Three hundred ninety-six new institutions joined last year.

- Visa operates two worldwide electronic data communications systems which transferred nearly one billion transactions between member institutions in 1979, an increase of 40% over 1978.

- Half the households in the U.S. use one or more Visa services.

CONDITION OF THE INDUSTRY
(ANNUALIZED RETURN ON AVERAGE OUTSTANDINGS)



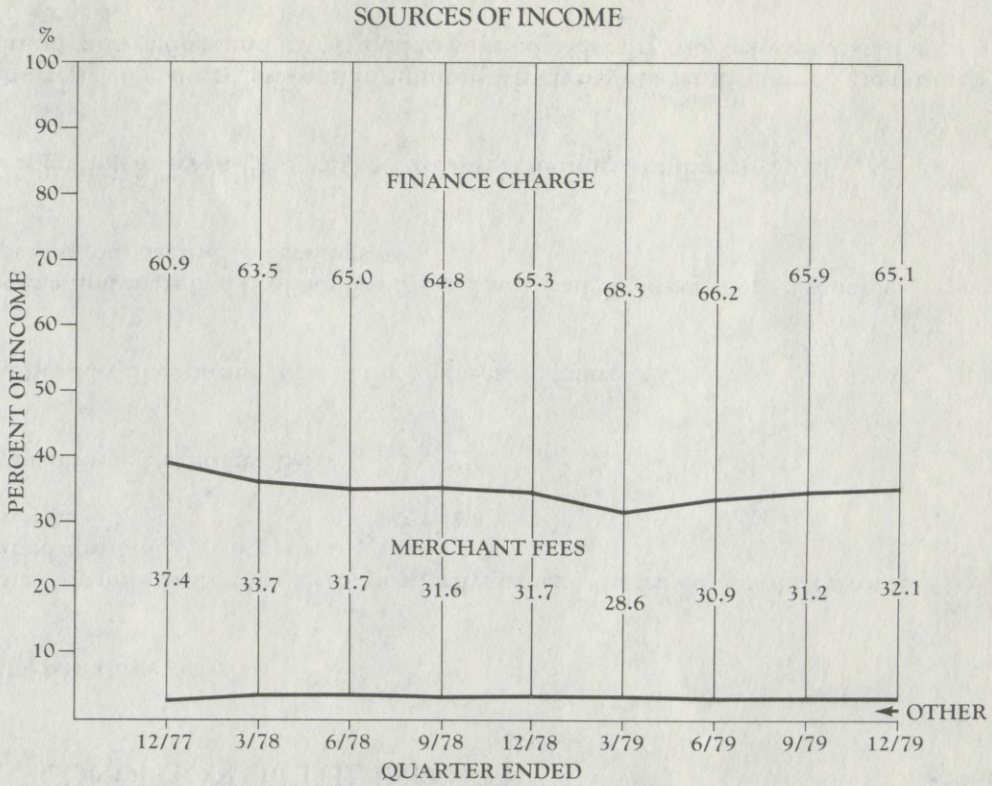
Reporting base before 1976: 100% of Visa programs reporting quarterly.
After 1976: Programs representing 65% of Visa and Mastercharge outstandings reporting quarterly.
Reporting system development supervised by Arthur Andersen & Co.

Forecast for first half of 1980 assumes revenues and costs remain constant as % of outstanding dollars, except cost of funds, which is assumed to rise to 12.2% (average for 1st half 1980) by retaining its historical relation to the prime rate (which is assumed to remain at 19% for remainder of 1st half).

No allowance has been made for increased losses due to:
(A) 15% deposit requirements.
(B) Increased credit losses due to higher unemployment or higher minimum repayment requirements.

CONDITION OF THE INDUSTRY

- Gross income has declined for the past three years.
- Operating efficiency improved steadily until December 1978, primarily through increased use of electronic technology, and has since remained constant.
- Fraud and credit losses have doubled since December 1977.
- Cost of funds has risen enormously and will continue high in the foreseeable future.
- After years of heavy startup expenses and marginal profitability, the industry had three years of reasonable profitability before the present precipitous decline in earnings.
- Based upon present conditions, operating losses in 1980 will be intolerable (almost $1 billion).
- Institutions in states with the most restrictive usury laws and institutions which have recently entered the business (primarily small banks, credit unions and savings and loans) tend to have considerably worse losses than the system averages represented in the chart.


SOURCES OF INCOME
%
100
90
80
70
60
50
40
30
20
10
PERCENT OF INCOME
FINANCE CHARGE
60.9
63.5
65.0
64.8
65.3
68.3
66.2
65.9
65.1
MERCHANT FEES
37.4
33.7
31.7
31.6
31.7
28.6
30.9
31.2
32.1
OTHER
12/77
3/78
6/78
9/78
12/78
3/79
6/79
9/79
12/79
QUARTER ENDED

SOURCES OF INCOME

- 50% of VISA's annual dollar volume is paid within the free period and incurs no finance charge (interest). This percentage has been increasing every quarter for 7 years.

- Finance charges are paid by customers who elect to pay in installments after the free period. These are generally the less affluent customers.

- In most cases, finance charge income from customers who extend balances cannot be increased due to limitations of state law.

- Most state laws do not authorize the imposition of charges to customers who elect to pay in full.

- There is a limit to the discount merchants will pay for bank card services. Intense competition for merchant deposits and the need to maintain a large merchant base makes it impossible to materially increase income from merchants.

- In 1979, total income of all types from all cardholders as a percent of the total dollars held by bank card customers was 14.2%.

BANK CARD PROFITABILITY BY SOURCE OF INCOME
(FOUR QUARTERS ENDED 9/30/79 IN $ MILLIONS)

	Merchant	Convenience Cardholder	Extended Cardholder	System Total
Income				
Finance Charges	—	—	$2,873	
Merchant Discount	$836	—	—	
Per Account Fees	—	$ 4	8	
Late Charges—Other	10	48	135	
Total Income	$846	$ 52	$3,016	$3,914
Expense				
Operating	$455	$388	$ 610	
Fraud and Credit Losses	2	218	341	
Cost of Funds	—	107	1,693	
Total Expense	$457	$713	$2,644	$3,814
4 Qtrs. End 9/30/79 Net Income	$389	($661)	$ 372	$ 100
1980 Forecasted Net Income[1]	$467	($853)	($ 509)	($ 895)
				(3.5%) of Outstanding Balances

NOTES

Amounts for entire bank card industry based on quarterly reports in uniform format by bank card programs representing 65% of all bank card outstandings. Non-reporting programs are smaller and newer programs, whose inclusion would further depress results. Reporting system development supervised by Arthur Andersen & Company.

[1] 1980 forecasted net income assumes:

(A) Outstandings remain at 12/31/79 level (20% higher than average during 4 qtrs. ending 9/30/79)

(B) Volume and all revenues and expenses also increase 20% over 4 qtrs. ending 9/30/79, except for cost of funds, which is assumed to increase to 12.5% by retaining its historical relationship to the prime rate (which is assumed to remain at 19% for the remainder of 1980)

STATE LAWS FORCE SOCIALLY AND ECONOMICALLY UNSOUND PRICING

- Cardholders who use bank cards as a payments device by paying within the free period were subsidized $661 million in 1979 and will be subsidized $853 million in 1980. These are generally the more affluent consumers.

- Bank card credit and consumer credit in general are substantially underpriced in today's market. This provides a strong consumer incentive to borrow.

- Since few states authorize charges for the payments services provided to convenience users, financial institutions have been forced to rely on debt to provide 65% of the revenue of card programs. This provides an incentive to sell debt rather than payments services.

- No allowance has been made for increased losses due to 15 percent reserve requirements, and increased credit losses due to higher unemployment or higher minimum repayment requirements.

STATE LAWS REGULATING BANK CARD CHARGES[1]

Fees Unrelated to Credit		
Permit Any Charge for Card Services	Expressly Permit Annual Charges on Lender Cards	Allow Maximum Interest[2] Rates Greater Than 18%
New Hampshire[4]	Colorado	California[5]
	Connecticut	Missouri ($1,000)
	Idaho	Nevada
	Illinois[8]	New Hampshire
	Indiana	Ohio ($400)
	Iowa	Rhode Island
	Kansas	South Dakota[7]
	Maine	
	Minnesota[6]	
	Oklahoma	
	South Carolina	
	Utah	
	West Virginia	
	Wyoming	

Notes:

1—This chart is intended to provide an overview and is not a definitive analysis of each State's laws.

2—Figures in parentheses indicate amount of balance over which interest lower than 18% is permitted.

3—Figures in parentheses indicate amount of balance on which 18% is permissible; lower rates apply to portion of balance over this amount.

4—Interest on written contract limited by reasonableness and conscionableness.

Maximum Interest Rates on Unpaid Balances

Permit 18% Interest on Entire Balance	Permit 18% Interest[3] on a Portion of Balance	Limit Interest to Rates Lower Than 18%
Alabama	Alaska ($1,000)	Arizona (16%)
Colorado	Delaware ($1,000)	Arkansas (10%)
Florida	D.C. ($500)	Connecticut (15%)
Georgia	Iowa ($500)	New Jersey (15%)
Hawaii	Maryland ($500)	Oregon (15%)
Idaho	Massachusetts ($500)	Pennsylvania (15%)
Illinois	Mississippi ($800)	Washington (12%)
Indiana	Nebraska ($500)	
Kansas	New Mexico ($500)	
Kentucky[9]	New York ($500)	
Louisiana	Puerto Rico ($250)	
Maine	Texas ($1,500)	
Michigan	Vermont ($500)	
Minnesota[6]	West Virginia ($750)	
Montana	Wisconsin ($500)	
North Carolina		
North Dakota		
Oklahoma		
South Carolina		
Tennessee		
Utah		
Virginia		
Wyoming		

5—No limit on interest charged by regulated financial institutions.

6—$15 annual fee if finance charge is 12% or less.

7—18% of balance over $500.

8—Limited to $20 per year.

9—Banks only.

CONSUMER IMPACT

- Because of a critical earnings problem, announced credit controls, and increased credit and fraud losses, providers will be forced to allocate credit and card payment services on the basis of least risk. Bank card payment and credit services to younger and lower income consumers, who need them most, will be extremely difficult, if not impossible to obtain. The more affluent consumer will not be affected to the same degree.

- Smaller institutions, faced with severe operating losses, high cost of funds and costly regulatory requirements, will be forced to terminate programs or severely cut back the number of account relationships, thus having to deny service to customers regardless of their income levels.

- Since the announcement of credit controls, unused credit lines have been activated by consumers with one or more cards as a hedge against a perceived decreasing money supply. For example, cash advance volume on Visa cards increased 50 percent in the first day following the President's announcement. State and federal notice requirements with respect to modifying customer contracts prevent immediate control of the problem. If this run on credit continues, outstanding balances will swell beyond the base date level and further increase operating losses.

- Limited money supplies and increased minimum payments will lead to widespread default by consumers. Many families, regardless of income, require a short-term source of funds to meet extraordinary expenses (e.g., income and property taxes). Lack of availability of such funds will contribute to insolvency and increased credit losses will contribute to already intolerable operating losses.

- When conventional sources of funds are unavailable, or are in short supply, many consumers turn to unregulated and unlawful sources for funds. Physical and economic abuse inflicted on the less affluent by illegal lenders has been well documented for generations.

- Consumers have come to rely on major cards as the primary means of economic identification, nationally and internationally, in order to cash checks, rent automobiles and register at hotels, regardless of whether the card was used to pay for the transaction. Inability to obtain a card will deprive customers of essential services which have nothing to do with debt or inflation.

IMPACT ON SMALL FINANCIAL INSTITUTIONS

- The largest financial institutions are already operating in, or can readily move to, one or more states which have little or no regulation of finance charges or fees. This is an option for only a select few. In fact, the most restrictive state usury laws are generally found where unit banking and small credit unions are most prevalent.

- Recent court cases have held that it is the law of the state in which the card is issued, not that of the cardholder's residence that governs charges.

- It is entirely practical to issue cards nationwide from a single location. In fact, it has been common practice not to cancel accounts when customers move to a remote area.

- Financial institutions operating in states in which usury laws make the program financially impossible have no choice but to drastically reduce or eliminate their programs, or sell them to large institutions. Several sales have already occurred. The largest institutions recently have had innumerable inquiries from smaller institutions which feel they cannot continue.

- In the event the Federal Reserve allows the debt base established March 14th to be transferred from selling institutions to purchasing institutions, a massive dislocation will begin. Large institutions can increase their programs enormously and establish nationwide cardholder bases, without incurring special reserve requirements by purchasing existing programs at distressed prices, or by offering higher priced cards from out-of-state to replace those cancelled.

- If debt base figures are not transferred, a great many institutions may be without a market to sell, and thus locked into disastrously unprofitable programs requiring liquidation.

- Savings and loans, mutual savings banks and credit unions have only recently entered the card business. They are either in the middle of large start-up costs, or about to launch programs. Those in the start-up phase have little chance to continue. Those about to begin are effectively precluded from ever offering service to their customers.

- In the very near future, the maturity of the automated clearing house movement will permit a financial institution to solicit automated deposits nationwide from a single location. The convenience and cost to a consumer of depositing remotely, rather than locally, will be identical. The same is true of government payroll, pensions, etc.

- Convenient access to banking accounts whether checking, savings or credit will increasingly depend upon an automated card device which permits purchases, or otherwise provides access to the account, twenty-four-hours-a-day, seven-days-a-week, nationally and internationally. Bank cards can readily be converted to deposit accounts by soliciting automated deposit, or other payments in advance of need.

- Elimination of card activity, technology and expertise from small and medium-sized institutions will effectively preclude them from offering the kind of service and access that will be essential to consumer banking.

- Current monetary policy has made the program unprofitable in nearly all but unregulated states and impossible in low rate states. The problem did not exist when low money costs permitted profitable operation in the lowest rate states since competition kept prices comparable in the highest rate states.

- Success or failure are no longer determined by operating ability; ability to compete is arbitrarily restricted.

LOSS OF MARKET SHARE BY SMALL RETAILERS

- Nearly every small retailer and most of those of medium size are entirely dependent on bank cards for convenience purchasing, and financing of merchandise.

- Most have disbanded internal credit programs in reliance on bank card service. They have also eliminated the forms, procedures and personnel necessary to prepare and process individual title retaining contracts on household furniture and appliances.

- A substantial diminishment of bank card service would leave them without any practical alternative in competing with large merchants who maintain their own credit programs.

- The effect would be particularly damaging in restrictive state markets where card programs are likely to be disbanded or severely restricted.

- This will occur just ahead of the peak fall selling season.

- Major merchants with internal credit programs will find special reserve requirements a small price to pay for acquisition of market share, since even minute shifts of retail markets can be extremely profitable.

IMPACT ON PAYMENT SYSTEMS

- In the early part of the century consumers' credit was not available from legitimate sources due to stringent usury laws. Consumers resorted to illegal lenders whose abuses were legendary. Special legislation exempting consumer loan companies was adopted. Rates from 24 percent to 36 percent were considered reasonable when the prime rate was 5 percent and savings rates 2 percent.

- The majority of consumer credit was provided at similar rates and with similar money costs through the thirties, forties and into the fifties.

- In the next two decades, through the development of card accounts, computerized accounting and open end credit, retailers, banks and some private companies reduced the cost to consumers to 18 percent or less, even though money costs doubled.

- A substantial portion of bank card growth is not new debt at all. It is a transfer from less efficient, less convenient, higher cost sources. Another substantial portion is nothing but an accumulation of purchases until statements can be rendered to those who pay in full. In 1979 bank card outstandings increased less than the rate of inflation. In real dollars bankcard debt declined.

- The combination of cards, computers and open-end credit have created electronic clearing systems which have already truncated paper between financial institutions, and recently between retailers and card issuers (i.e., the Visa/JCPenney computer connections).

- A nationwide system of point of sale terminals has been designed and was scheduled for possible implementation in 1981. It would permit authorization of every transaction at point of sale. This would permit safe delivery of electronic payment devices to virtually every citizen and better control of credit extended. The project has been suspended due to uncertainty of present conditions.

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- The Visa BASE II computer systems can electronically, within twenty-four hours, acquire all transactions from institutions worldwide, translate language into the cardholder's native tongue, convert each transaction to the currency of the cardholder at wholesale bank rates, transmit all required financial data to the issuing institution, (including selling merchant's name and currency conversion rate) and provide a single daily net settlement between each institution, and all other institutions worldwide. The cost is 12¢ per transaction.

  The same services, to the extent required, are provided between U.S. institutions for 1¢ per transaction.

- Nearly 50 percent of the members joining Visa International outside the United States extend no credit with their cards. Transactions are electronically deducted from deposit accounts as received.

- Within the United States for many years Visa has followed an orderly process to convert from a pure credit card to a card primarily used to access deposit accounts.

- More than 140 U.S. banks are already issuing Visa cards with transactions immediately deducted from deposit accounts. A substantial number of savings institutions have done likewise. Dozens of others had plans to launch similar programs within months. Most have indefinitely postponed their plans.

- There is little doubt, until the past six months, that the bank card would be the device which would lead the U.S. payments system from reliance on paper to reliance on electronic impulse.

- Half of all U.S. volume on bank cards is paid within thirty days of billing. These customers are not users of credit. In the near future they could be converted to direct deduction from deposit accounts if the industry is allowed to progress in a rational manner.

- The evolutionary electronic payment movement is largely dependent on wide dissemination of cards in both the financial and retail environment, and upon the financial soundness of the underlying card programs.

- The entire process is in jeopardy. The gains in productivity which have been achieved in the dispensing of credit and in the handling of electronic payments can easily be set back five years if the present situation continues.

- Decreased productivity will fuel, not diminish inflation.

ANALYSIS

- Inherent in every payment device are two separate and distinct services which should be recognized by the law and separately priced. The first is payment for goods or services, and the second is extension of credit.

- The first traditionally has been priced in free and open competition and not subject to usury laws. The second traditionally has been subject to usury laws.

- The use of electronic technology and plastic cards has made it possible to combine multiple functions in a single device. This has blurred the distinction between what constitutes payment services and what constitutes extension of credit.

- For example, checking account services are viewed as payment services, and the pricing has never been subject to regulation. Lines of credit are often provided to checking account customers which permit the customer to write checks against either funds on deposit or the line of credit. The means (checks and checking account) by which the customer accesses the credit are not considered the loan of money, even though some funds may be involved in the process. Usury applies only when the transaction is included in the balance which the customer elects to pay in installments.

- Travel and entertainment cards take the process an additional step. Transactions are consummated by use of a card and paper sales draft. They are accumulated, billed monthly to the consumer with the full amount due within a specified period after billing.

  The entire process is considered a payment service and is priced unrelated to the funds outstanding, which are not considered the loan of money with respect to usury statutes or APR disclosures. It is only when the cardholder elects to pay in installments through a prearranged line of credit with a financial institution that the usury statutes apply. Since the two services, payment and extension of credit, were developed at different times and are handled by separate organizations, the distinction has been traditional and clear.

- Bank cards combine the same two distinct services. Whether the card is used solely as a payment device, or as a credit device by deferring payment of the full balance, is determined by the cardholder. Since the services are developed and offered simultaneously by a single institution, the distinction between the separate services has never been clearly recognized by law or by their functions in the marketplace.

PROPOSED LEGISLATION AND/OR REGULATION

A substantial portion of the financial and retail community feels that state usury laws should be preempted by Federal legislation and all charges for payments services or credit be established by free market competition. Consideration of such proposals may take considerable time. Institutions offering bank card credit and payment services have critical problems which can be addressed by the following proposals:

1. Clarification of Charges for Payment Services

The entire process by which a transaction is completed between cardholder and merchant and paid in full by the customer should be considered a payment transaction, which should be priced in an open market free of restraint.

This process should include the providing of a card or other transaction device, the consummation of a sale, the entry of the transaction into financial systems, the return of the transaction to the institution which provided the device, the deduction of the transaction from a deposit account and/or the billing of multiple transactions to the customer together with a reasonable time within which the customer may elect to pay in full.

The funds necessary to complete this cycle should be considered the lubricant necessary to the process, and not an extension of credit.

It is only when the customer elects to pay in installments that the funds should be considered a loan (extension of credit) subject to usury laws and APR disclosures. The necessary legislation should be national and should supersede state law.

2. Suspend Notice Requirements

To permit early implementation of new charges pursuant to Paragraph 1 above, providers of the payment devices should not be required to comply with the multitudinous Federal and state disclosure requirements. In lieu of those requirements, the user of the device should be given fifteen days prior written notice and should not be charged new fees if the user discontinues use of the device within the notice period.

3. Minimum Payment on the Account

In order to accelerate repayment of existing balances, providers of payment devices should be permitted to increase the minimum monthly payment on existing outstanding balances, as well as future balances, with fifteen days prior written notice. The customer should have the option to pay in accordance with the existing contract by discontinuing use of the payments device within the notice period.

4. Remove 15 Percent Reserve Requirement on Nondeferred Balances

Balances necessary to fund the payment cycle described in Paragraph 1 above, should be exempt from the 15 percent special reserve requirement. Only if the consumer defers payment beyond that period should balances be included in the reserve requirement.

5. Adjust "Base Date" of March 14 for Peak Volumes

The Base Date of March 14 for establishing reserve requirement failed to take into account traditional peak sales periods. Some relief from reserve requirements with respect to peak selling seasons should be provided.

6. Exclude Durable Goods from Reserve Requirements

In order to exempt the purchase of durable goods from the reserve requirement, the creditor must take the goods as collateral on a closed-end contract. This precludes use of efficient payment devices, such as open-end credit, and forces creditors into archaic, expensive methods. Durable goods should be exempt from the reserve requirement, regardless of how they are financed.

CONSUMER PAYMENT SYSTEMS ACT

SECTION 1: Short Title.

This Act may be referred to as the "Consumer Payment Systems Act."

SECTION 2: Congressional Findings and Purposes.

Congress finds that new devices for effecting consumer and business transactions are being developed and offered by a variety of competing institutions nationwide. Congress further finds that these devices are convenient and efficient means of effecting payment and other financial services to consumers. These devices increase productivity, which is essential if inflation is to be controlled. It is the purpose of this Act to assure that these devices continue to be made available to consumers and to foster more efficient payments systems.

SECTION 3: Definitions.

(a) The definitions set forth in this section are applicable for the purpose of this Act.

(b) The term "account" means any account, including a deposit or credit account, which may be debited or credited by use of a payment device.

(c) The term "providor" means a person or a legal entity, whether a corporation or otherwise, which provides a payment device to a user.

(d) The term "State" refers to any State of the United States, the Commonwealth of Puerto Rico, the District of Columbia, and any territory or possession of the United States or any subdivision or agency thereof.

(e) The term "transaction" means a use of a payment device which gives rise to a debit or credit to an account.

(f) The term "payment device" means any device which may be used to debit or credit an account.

(g) The term "payment device fee(s)" means any fee or fees contracted for and received pursuant to Sections 4 and 5 of this Act, including an annual fee, a monthly fee, a fee related to the number of transactions or the dollar amount of the transactions.

SECTION 4: Payment Device Fees.

In addition to any other charges, including interest, permitted under applicable Federal or State laws and regulations, a providor of a payment device may contract for and receive from a user payment device fees, provided such fees accrue (i) whether or not the payment device is used, or (ii) if related to a particular transaction, during the period of sixty days from the time the providor receives or originates a transaction arising from the use of such device or thirty days after billing the transaction, whichever period first terminates.

SECTION 5: Notification to User.

Before a payment device fee permitted by Section 4 of this Act may be imposed upon a user who has not previously agreed to pay such fee, the issuer must give at least thirty days prior written notice to the user (i) of the imposition of such fee and the amount thereof and (ii) advising the user that the user may avoid payment of the payment device fee by no longer using the payment device after thirty days from the date of the notice.

SECTION 6: Preemption and Nondiscrimination.

(a) The provisions of the constitution, laws or regulations of any State providing, limiting, or in any way regulating the contracting for and receiving of a payment device fee, including the rate or amount thereof, shall not apply to any payment device fee contracted for and received in accordance with Sections 4 and 5 of this Act.

(b) No constitution, law or regulation of any State shall discriminate as to the amount of finance charge, interest, credit service charge, or the like, which may be contracted for and received in connection with the use of a payment device, including charges on the outstanding balance on the account, based on whether or not a payment device fee, or the amount thereof, is imposed by the providor.

(c) The Truth in Lending Act does not apply to any payment device fees contracted for and received in accordance with Sections 4 and 5 of this Act.

SECTION 7: Interpretations.

The Federal Reserve Board shall interpret the Act.

ANTICIPATED RESULTS OF ADOPTION OF THE SIX PROPOSALS

- It will be unnecessary to rely on finance charges from extended balances to support card programs. Profit opportunities will shift from marketing cards as debt instruments to marketing them as payment instruments. Indeed, a trend in that direction is already apparent where the law permits.

- Since card accounts can be operated nationally from a single location and deposits acquired nationally through automated clearing houses, there would be no unit bank or isolated market protected from competition. At the same time, even the smallest institution could enter the competition.

- The prices charged for card payment services could not rise above a modest amount in excess of costs since there would be intense competition and a price appreciably beyond that necessary would subject the offending institution to loss of the entire account relationship.

- The less affluent will no longer be required by law to subsidize the wealthy.

- Immediate relief will be available to correct critical earnings problems.

- Charges for the basic payment service inherent in cards will become prevalent. Cardholders will cancel cards which they carry but rarely use. This will substantially reduce the lines of credit which may be drawn upon without the necessity of asking for a card. It will increase industry productivity by eliminating inactive and seldom used cards.

- Reduced credit lines, increased repayment schedules and other required measures can be achieved without intolerable operating losses.

- Substantial withdrawal of cards will not be necessary since the basic price will be related to service rendered.

- Small banks, credit unions, and savings institutions which will otherwise be disenfranchised by discriminatory usury laws and their newness to the industry will not be at the mercy of large institutions.

- There will be a sufficient supply of card services to support small and medium retailers in their competition with the giants in the industry.

- The economic base upon which efficient payment systems are being built will not be destroyed.

- The relief which might otherwise be necessary under usury statutes would be mitigated (under present pricing arrangements finance charges of 28 percent to 32 percent on extended balances would be necessary to return the card industry to a reasonable level of profit).

- Prompt changes could be made to the terms of existing accounts, thus implementing credit restraint in the near future.

- Regulations would reflect the reality of selling seasons.

- Productivity in the distribution of credit and the payments system would not be diminished. It would, in fact, be encouraged.

- The law would clearly reflect the realities of the modern marketplace by recognizing that separate and distinct services can be efficiently combined in a single payments device.

- It is quite likely that consumers, small financial institutions and small retailers may not share the perception that they are a primary cause of inflation but on the contrary, feel they have been made the scapegoat in an inflationary problem of which they are the victim, not the perpetrator.

  Immediate adoption of the proposals would do a great deal to mitigate such feelings.

I

96TH CONGRESS
2D SESSION

H. R. 7735

To amend the Depository Institutions Deregulation and Monetary Control Act of 1980.

IN THE HOUSE OF REPRESENTATIVES

JULY 2, 1980

Mr. LAFALCE introduced the following bill; which was referred to the Committee on Banking, Finance and Urban Affairs

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A BILL

To amend the Depository Institutions Deregulation and Monetary Control Act of 1980.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That title V of the Depository Institutions Deregulation and Monetary Control Act of 1980 (94 Stat. 161; Public Law 96–221) is amended by adding at the end thereof the following:

"PART D—CONSUMER CREDIT

"EXTENSIONS OF CONSUMER CREDIT

"SEC. 531. (a) The provisions of the constitution or the laws of any State expressly limiting the nature, rate, amount of, or manner in which interest, finance charges or other charges or fees which may be charged, taken, received, or reserved shall not apply to an extension of consumer credit.

"(b) Except as provided in subsection (c)(1), the provisions of subsection (a) shall not apply to any extension of consumer credit made pursuant to the laws of any State after the date (on or after the effective date of this section and before April 1, 1983) on which such State adopts a law or certifies that the voters of such State have voted in favor of any provision, constitutional or otherwise, which states explicitly by its terms that such State does not want the provisions of subsection (a) to apply with respect to extensions of consumer credit made pursuant to the laws of such State.

"(c)(1) Notwithstanding any other provision of the laws of the United States or of the constitution or the laws of any State, a creditor may impose transaction fees and access fees upon account holders pursuant to an open-end credit plan.

"(2) Any transaction fees and access fees imposed upon account holders pursuant to an open-end credit plan shall not be considered a component of the interest charge, finance charge, or other charge for credit under the constitution or

laws of any State expressly limiting the types, rate or amount of interest, finance charge, other charges, or fees which may be taken, received, or reserved by a creditor.

"(3) Notwithstanding the provisions of subsection (b), no State shall enact any law, regulation, or constitutional provision which shall in any manner limit or restrict the amount of interest, finance charge, other charges, or fees which may be contracted for, charged, taken, reserved, or received in connection with an open-end credit plan based on whether a creditor imposes transaction fees or access fees.

"DEFINITIONS

"SEC. 532. For purposes of this part—

"(1) the term 'access fee' means a fee or other charge which is related to the privilege granted by a creditor to a person to obtain access to an open-end credit plan;

"(2) the term 'credit' means the right granted by a creditor to a person to defer payment of debt or to incur debt and defer its payment;

"(3) the term 'creditor' means a person who regularly extends consumer credit, or who regularly arranges for the extension of consumer credit, that is payable by agreement in installments or where the payment of interest, a finance charge or other charge or fee is or may be required, whether in connection

with an extension of credit, sales of property or services, or otherwise;

"(4) and for purposes of section 528, the term 'extension of consumer credit' means credit offered or extended by a creditor to a person, primarily for family, household, travel, entertainment, or personal purposes;

"(5) the term 'open-end credit plan' means the extension of consumer credit on an account pursuant to which—

"(A) the creditor may permit the account holder to make purchases or obtain loans, from time to time, directly from the creditor or indirectly by use of a credit card, check, or other device; and

"(B) a finance charge may be computed by the creditor from time to time on an outstanding balance;

"(6) the term 'person' means a natural person or an organization, including a corporation, partnership, proprietorship, association, cooperative, estate, trust, banking organization, or governmental unit; and

"(7) the term 'transaction fee' means a fee or other charge which is imposed by a creditor upon the

occurrence of a transaction with respect to an open-end credit plan.

"REGULATIONS

"SEC. 533. The Board of Governors of the Federal Reserve System is authorized to issue rules and regulations and to publish interpretations governing the implementation of this part.".

SEC. 2. Section 106 of the Truth in Lending Act (15 U.S.C. 1605) is amended by adding at the end thereof the following new subsection:

"(f) The following items, when charged in connection with an open-end credit plan, shall be excluded from the computation of the finance charge with respect to such plan:

"(1) any fee or other charge related to the privilege granted by a creditor to a consumer to obtain access to credit pursuant to such plan; or

"(2) any fee imposed by a creditor upon the occurrence of a transaction pursuant to such plan.".

SEC. 3. Section 528 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (94 Stat. 168; Public Law 96–221) is amended by striking out "the same loan, mortgage, credit sale, or advance, such loan, mortgage, credit sale, or advance" and inserting in lieu thereof "the same loan, mortgage, credit sale, extension of consumer

credit, or advance, such loan, mortgage, credit sale, extension of consumer credit, or advance".

SEC. 4. The amendments made by this Act shall take effect on the date of the enactment of this Act.

Senator MITCHELL. I have no further questions.

The final witness is Mr. Lewis Goldfarb, Director of the Credit Practices Division of the Federal Trade Commission.

Welcome. Have you been here all day?

STATEMENT OF LEWIS GOLDFARB, DIRECTOR, CREDIT PRACTICES DIVISION, FEDERAL TRADE COMMISSION

Mr. GOLDFARB. Yes.

Senator MITCHELL. I am sorry we kept you so long. Also, you do not have too much time because I preside in the Senate at 4 o'clock.

Why don't you summarize your statement, if you could, please.

Mr. GOLDFARB. OK. Thank you.

Let me first say my comments represent the views of the staff of the Bureau of Consumer Protection, and not those of the Commission or any individual Commissioner.

We strongly support the creation of a proposed Consumer Usury Study Commission to examine issues raised by any further Federal preemption of State usury laws.

We believe there are significant questions which should be carefully reviewed and answered prior to further Federal action. While there has been much debate on the impact of usury laws on cost and availability of credit, to our knowledge there has been no objective, comprehensive study sufficient to guide Congress at this time as to how to specifically deal with the problem.

Senator MITCHELL. You reject the argument we heard today there has been all kinds of study and plenty of data and we don't need to look at this problem more?

USURY LAWS ARE IMPEDIMENTS TO FREE COMPETITION

Mr. GOLDFARB. There have been plenty of studies and a lot of data in the field which suggest the usury laws are impediments to free competition and may increase the cost and reduce availability of credit. No one disputes that.

What many believe is that there have not been studies which are sufficient to guide Congress exactly as to how to go about doing this, to deal with all the issues that came up today, for example. There was much controversy in the discussion this afternoon and this morning.

Senator MITCHELL. What about the question raised by Ms. Alexander of enforcement? Who presently enforces the law in the areas where she indicated Federal law has been enacted preempting State laws and no provision was made for enforcement?

Mr. GOLDFARB. I think there is enforcement to the extent the Home Loan Bank Board enforces its own regulations. It would rely on States to enforce it. That is another issue the Study Commission would have to take up.

I would also point out while the National Commission on Consumer Finance did study the issue, it concluded that usury laws got in the way of free competition; that Commission also suggested that the States consider ways to deal with the usury problem and that no action be taken until it be determined that there is competition in markets.

This is a critical proviso to the National Commission recommendation as well as the Interagency Task Force on Thrift Institutions recommendation.

The task force also said that if competitive conditions exist in the market, then the usury limits or the rate ceilings, should be altered or eliminated.

Senator MITCHELL. Is there competition now?

Mr. GOLDFARB. That is a disputed fact. Some believe there is. In some markets there is and in some there is not.

Again, that is another important issue that the Study Commission will have to take up. There are a number of other issues the commission would take up which are critical before any action is taken, such as whether the lifting of rate ceilings should be gradual or immediate.

Whether any Federal action should be subject to State override.

Whether a maximum rate should be tied to some economic indicator or the Federal Reserve Board discount rate.

What the impact on other Federal laws and regulations would be.

From the standpoint of consumer protection, a particularly important issue is whether consumers should be granted additional protection as a result of raising rates. Limitations of creditor remedies in collection practices and prohibition of the use of rule 78 to calculate refund under finance charges are examples of such protections.

It may be argued that once creditors are granted relief from rate limitations they should not be permitted to impose additional hidden costs in the form of collection remedies or prepayment penalties.

High rates combined with harsh practices might be found to cause more harm than good.

With regard to the Cash Discount Act, the most significant issue raised by that bill is its continued prohibition of surcharges on consumers using credit cards.

In our experience small merchants adopting programs to insure that cash customers don't pay the costs associated with accepting credit cards invariably do so by imposing a surcharge rather than by granting discounts for cash. It's too cumbersome and costly for them to effectively offer discounts for cash.

In cases in which we have contacted these merchants and notified them the practice is illegal, the uniform response has been to abandon the practice altogether and not revert to cash discounts.

Senator MITCHELL. Are you suggesting that continuation of the situation where cash discounts are permitted but surcharges are prohibited would make this whole thing futile? There simply wouldn't be cash discounts?

Mr. GOLDFARB. You will not see an increase in the number of merchants offering cash discounts.

Senator MITCHELL. That is a de minimis number now?

Mr. GOLDFARB. Yes, from our experience.

Senator MITCHELL. All this oration about how we will encourage and permit cash discounts, if it's not accompanied by the authority to impose surcharges, it doesn't really mean much, does it?

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Mr. GOLDFARB. Not really. I think where the merchant offers the choice of both, obviously, you would see a great increase in surcharges and you will not see an increase if the choice is limited.

Ultimately, the questions of whether credit card issuers themselves should be allowed to impose transaction charges or seek additional forms of compensation not now permitted by State law will be faced by the proposed Study Commission.

AMEND CASH DISCOUNT ACT

As an interim measure, we would recommend that the Cash Discount Act be amended to allow merchants accepting third party cards to impose a surcharge equal to the amount of the discount the merchant would pay the card issuer.

Senator MITCHELL. Are you acquainted with the work of the interagency panel to which reference was made so often today?

Mr. GOLDFARB. You are referring to the Interagency Task Force on Thrift Institutions. Yes; I am acquainted with it.

Senator MITCHELL. Do you know whether or not there was any significant degree of input by consumer organizations or State officials into that study?

Mr. GOLDFARB. Let me make a few comments on this point.

For one, the FTC was not aware this study was underway until the report was published.

Senator MITCHELL. Does FTC have Federal jurisdiction over finance company activities?

Mr. GOLDFARB. Yes.

Senator MITCHELL. So the agency with specific jurisdiction in the area involved was not even aware the study was being conducted.

Mr. GOLDFARB. That's correct. I also suggest you look at the roster of the members of the Task Force from all the agencies who were involved and you will find that, though each of these agencies has its own consumer protection division, none of the members of this Task Force is from the consumer affairs offices of those agencies.

The Federal Reserve Board has a large Consumer Affairs Division. No one from that Division was on the Task Force. The same is true with the Comptroller of the Currency, Bank Board and the others. They made no effort to seek what I think is a well-rounded public input on that very important question.

Senator MITCHELL. Is that one reason you would prefer to see this matter studied by a new and independent commission as opposed to merely relying on the interagency task force, as suggested earlier?

Mr. GOLDFARB. Based on results, yes.

Senator MITCHELL. Thank you very much, Mr. Goldfarb. I appreciate your testimony. I am sorry you had to wait so long, but there is an old saying, we save the best for last.

I wanted to emphasize to everybody that one of the things I learned as a judge is never to let the lawyers know what you are thinking. So my questions should not be construed to indicate a particular point of view one way or the other.

I thank you all very much. We will take this up in the near future. The hearing is completed.

[Whereupon, at 3:55 p.m., the hearing was adjourned.]

[Complete statement of Mr. Goldfarb and an additional letter received for the record follow:]

Statement of

Lewis H. Goldfarb
Assistant Director
for Credit Practices
of the
Bureau of Consumer Protection
Federal Trade Commission

on

H.R. 7340 - The Cash Discount Act
and
Proposals for A
Consumer Usury Study Commission

Before

The Subcommittee on
Consumer Affairs of
The Senate Committee on
Banking, Housing and Urban Affairs

Thursday, July 24, 1980

The remarks represent the views of the Staff of the Bureau of Consumer Protection and do not necessarily represent the views of the Commission or of any particular Commissioner.

GOOD MORNING:

Thank you for the opportunity to appear before you today to present the views of the staff of the Federal Trade Commission's Bureau of Consumer Protection on H.R. 7340, the Cash Discount Act, and this Subcommittee's proposal to create a national commission to study federal preemption of state usury laws. My comments today represent my own views and do not necessarily represent the views of the Commission or of any particular Commissioner.

Consideration of these two subjects is timely and they are clearly related. The Truth in Lending Act's present cash discount provisions now permit partial preemption of state usury laws and the proposed Cash Discount Act would eliminate the present 5% ceiling on such discounts thus greatly expanding the preemption. Moreover, as you know several segments of the credit market have already been subjected to a full or partial preemption of state usury laws and other representatives of other sectors are currently seeking similar exemptions.

I. Proposed Consumer Usury Study Commission

We strongly support creation of the proposed consumer usury study commission to examine the issues raised by any further Federal preemption of state usury laws. We believe that there are significant questions which should be carefully reviewed and answered prior to further federal action.

Usury laws represent one of the longest standing and most common

forms of economic regulation. The National Commission on Consumer Finance traced such laws as far back as the 24th century B.C. Every state in this country has some form of usury laws. Moreover, such laws have significant individual impact for almost every consumer. Before such laws are preempted by federal legislation, further examination is appropriate.

Much debate on this topic has already occurred. Economists for years have pointed out that in many cases usury laws may disrupt orderly allocating of credit costs by the market, restrict the available supply of credit and, in some cases, actually increase the cost of credit by serving as a barrier to entry to the market. The National Commission on Consumer Finance devoted a substantial portion of its resources to examination of rate ceilings. While the Commission concluded that, on balance, rate ceilings were undesirable, it did not recommend immediate abolition, but instead counseled states to evaluate the competitiveness of their markets before considering raising or removing the ceilings. [1] I view this as one of the most important questions which a study commission should address: are there presently credit markets which are not sufficiently competitive to justify removal of rate ceilings?

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[1] Consumer Credit in the United States, Report of the National Commission on Consumer Finance (1972) 108, 147-149.

There are, of course, a host of other questions, which should be answered, many of which are outlined in your letter of July 12. Of particular importance are the questions of:

-- Whether the lifting of rate ceilings should be immediate or gradual?

-- Whether any federal action should be subject to a state override?

-- Whether a maximum rate should be tied to some economic indicator or the Federal Reserve Board discount rate?

-- What the impact on other federal laws and regulations would be? [2]

From the standpoint of consumer protection, a particularly important issue is whether consumers should be granted additional protection as a result of raising rates, for example, limitations of creditor remedies and collection practices or prohibition of the use of the "Rule of 78's" to calculate refunds of unearned finance charges.

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[2] The Extortionate Credit Transaction Act, for example, makes an extension of credit at a rate in excess of 45% an element of a prima facie case or criminal case. Other Federal regulations set maximum charges for certain government guaranteed credit transactions.

It may be argued that once creditors are granted relief from rate limitations they should not be permitted to impose additional hidden costs in the form of onerous collection remedies or prepayment penalties. High rates coupled with harsh collection practices might ultimately be found to cause more harm than good.

II. The Cash Discount Act

We are in general support of the purpose of the Cash Discount Act, which we understand is to encourage more merchants to establish cash discount programs. As to that Act, I have only three recommendations. First, I believe the existing statute's requirement that the cash discounts must be generally available to all cash customers is an important one and should be retained. This provision ensures that consumers who do not have credit cards can receive the discounts.

Secondly, the Act removes the existing 5% ceiling on cash discounts. In our experience, the limitation on the amount of the discount has not been a particularly important reason for the general reluctance of merchants to offer cash discounts. Because I fear that an unlimited discount could be used to subvert the Truth in Lending Act's general policy of promoting informed use of credit through full disclosure of cost, I believe some ceiling should be retained, at least until the proposed study commission has had an oportunity to evaluate this area.

The most significant issue raised by H.R. 7340, however, is its continued prohibition of surcharges on consumers who use credit cards. In our experience small merchants who adopt programs to ensure that cash customers do not pay the costs associated with accepting credit cards, invariably do so by imposing a surcharge rather than granting a discount for cash. It is too cumbersome and costly for them to effectively offer discounts for cash. In cases in which we have contacted these merchants to notify them that the practice is illegal, the uniform response has been to abandon the program, not to institute a cash discount program. Moreover, in at least one case, the merchant expressed dismay that the law allowed him to raise his cash price and then grant a discount but not to take the much simpler step of simply imposing a surcharge.

From an economic standpoint, a surcharge and a discount are equivalent concepts except that one is hidden in the cash price and the other is not. From a practical standpoint, the surcharge seems easier to implement and more likely to ensure that the cash price does not reflect the cost of accepting credit cards. [3]

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[3] There are inherent costs in accepting these cards including the discount the merchant pays the card issuer and administrative costs. There is, however, an underlying economic question of whether the increased sales from credit card programs actually result in lower cash prices for all customers.

Ultimately, the question of whether credit card issuers themselves should be able to impose surcharges, transaction charges or seek additional forms of compensation not now permitted by state law will be faced by the proposed study commission. As an interim measure, I would recommend that the Cash Discount Act be amended to allow merchants accepting third party credit cards to impose a surcharge which is equal to the amount of the discount the merchant will pay the card issuer. If such a provision is enacted it should be coupled with a provision requiring merchants to clearly disclose that they impose such surcharges both at point of sale and in any advertisement stating that they accept third party credit cards.

I hope that you will find my views of assistance in considering this legislation.

ALEXANDRIA, VA., *July 27, 1980.*

Hon. GEORGE J. MITCHELL,
Chairman, Subcommittee on Consumer Affairs, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Dirksen Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: You will recall that I spoke to you after the hearing last week on H.R. 7340, To amend the Truth in Lending Act to encourage cash discounts, and for other purposes, at which there was not an opportunity for me to testify. Accordingly, I am submitting my views in this letter, which I request be made a part of the record of the hearing.

In order to explain my interest in the proposals considered at the hearing, and to disclose the fact that I may be considered biased, I wish to state that I was on the staff of the Senate Banking and Currency Committee from 1955 to 1967, I was general counsel of the American Bankers Association from 1967 to 1975, and I was counsel to the Washington office of Cleary, Gottlieb, Steen & Hamilton from 1975 through 1979. During my service in these capacities, I had many occasions to work on facets of Truth in Lending, both the Act and the related regulations, and bank cards and bank card systems, and in 1975 I testified before this Subcommittee at a hearing on Two Tiered Pricing on behalf of one of the bank card organizations represented at the time by the law firm with which I was associated.

However, I am no longer associated in any way with any of those organizations, having retired fully, and I am writing solely as an individual, in order to bring to the attention of the Subcommittee some considerations which I think were overlooked or not emphasized sufficiently at the hearing.

I start with the fact, to which you referred several times at the hearing, that there has been a very substantial expansion in the credit card business, both in the number of cards and in the amount of usage, in the past decade. This suggests to me that cards must be supplying a service desired by consumers, by merchants, and by banks. Consumers do not have to get cards or to use them and merchants do not have to honor them; presumably both consumers and merchants find it to their benefit to use and honor them.

It was also pointed out at the hearing several times that the existing statutory provision that a discount of 5 percent or less for payment in cash or by check or other means not involving the use of an open end credit plan or a credit card shall not constitute a finance charge has not been used to any significant extent. Apparently consumer and merchants have not thought this provision was as beneficial to them as they have found credit cards to be.

The proposals to strike the five percent limitation on discounts and to repeal the prohibition on surcharges (and presumably to exclude them from finance charges) are designed to encourage cash discount programs and to discourage the use of credit cards and open end credit plans.

In my opinion, it is a clear violation of the basic policy and purpose of the Truth in Lending Act to permit a merchant to give a discount for cash or to impose a surcharge for use of a credit card without reflecting the additional charge for credit in the finance charge and the Annual Percentage Rate. No matter how beneficial or desirable cash discount programs may be, I cannot escape from the conclusion that discounts for cash and surcharges for the use of a credit care are costs of credit, and if they are not included in the finance charge and APR, the consumer is being denied information which the Truth in Lending Act requires that the seller or credit grantor should give to the consumer.

Accordingly, I am opposed to the removal of the five percent limitation on discounts and the repeal of the prohibition on surcharges, and I do not think the present provision on discounts is necessary or desirable, and should be repealed.

At the same time, I am convinced that the arguments in favor of cash discount programs are unsound, and that the experience of the last five years shows conclusively that neither consumers nor merchants consider them advantageous, even with the deceptive provision excluding five percent discounts from the usual and desirable disclosure provisions of the Act. On the contrary, I am convinced there are sound reasons why both consumers and merchants find cash discount programs unsatisfactory and undesirable.

The basic purpose of the Truth in Lending Act was to give a consumer full and complete, and easily comparable, information about credit being offered to the consumer, so as to make possible an informed decision as to whether to pay in cash or what form of credit to take. This purpose was accomplished by requiring that credit grantors give consumers full information on a carefully prescribed basis about the finance charge (the total cost of credit) and the APR for closed end credit and about the APR for open end credit.

The statutory and regulatory provisions designed to accomplish the purpose of the Act have been virtually endless, and efforts to simplify them have been almost as extensive. They have, however, given a very substantial measure of assistance and protection to consumers who seek useful information about the cost of credit from various sources. It is possible to compare one APR with another APR, or one finance charge with another finance charge on the same loan for the same period.

However, if these carefully devised rules are thrown off by a discount or surcharge of five or ten percent, which need not be included in the finance charge or APR, the consumer is not given the information needed; in fact the APR and finance charge given by the merchant or the card issuer becomes misleading to the consumer.

The situation is confused by the fact that the bank card system involves four separate contracts: one between the cardholder and the card issuing bank, another between the merchant and the merchant bank, another between the card issuing bank and the merchant bank, and the fourth between the cardholder and the merchant. The contract between the cardholder and the card issuing bank is the normal place for the specification of the APR and other terms of financing. Ordinarily the APR is at or close to the statutory ceiling, according to the witnesses at the hearing. Originally the contracts between the merchant and the merchant bank contained an agreement that the merchant would not give discounts for cash or impose surcharges for use of a card. But this provision was prohibited by the Truth in Lending Act, and discounts up to five percent need not be included in the finance charge. So the card issuing bank may well not know that a discount has been granted for cash purchases, and that the amount of the sale stated actually includes a charge for credit of up to five percent, on which the card issuing bank charges interest, and which, added to the card issuing bank's interest, may well exceed the maximum permitted under the applicable usury statutes. While neither the merchant's charge for credit nor the card issuing bank's interest may exceed the permitted rate, the consumer would have to pay an amount which, if charged by one creditor would be usurious. It is hard to explain how this benefits the consumer who uses a credit card.

One of the benefits of the Truth in Lending Act has been to eliminate the confusion which resulted from the old time-price doctrine, under which the difference between the cash price and the time price was not considered to be interest subject to the usury statutes. The current discount provision and the proposed surcharge provision seem to accomlish the same result as the old time-price doctrine, with equally undersirable results for the consumer.

The amount of the discount paid by the merchant to the merchant bank is a matter of negotiation between them, depending on the volume of business done by the merchant, and no doubt on the extent of others between the merchant and the merchant bank. Having been established, it is fixed, and consequently it is considered as a cost to the merchant related solely to the card business, which should not be a part of the price to cash customers, but should be passed on to the card user.

This attempt to allocate costs assumes a much more refined ability to allocate than exists in most cases. A consumer may go to a store because it offers a card, and buy a small item for cash when the large item the consumer had in mind is not available. Or the consumer may go to a store with a small amount of cash, expecting to buy some cheap item, and then use a card to buy an expensive item that catches the consumer's eye.

This also overlooks the fact that the use of cash involves a very considerable cost, even though it is not so easy to point to a precise figure. A large supply of cash in the merchant's cash registers costs a substantial amount of interest, presumably at prime rates if borrowed from the merchant's bank, or interest foregone if the merchant uses capital for the purpose. The risks of holdups and embezzlement are increased, as well as the chance of confusion and honest error. Getting cash to and from the merchant involves the use of an armored truck with armed guards, or a still greater risk of a holdup. Insurance against these risks is expensive. Merely counting a day's receipts in cash at a large department store must require many hours of labor, and getting additional cash when the registers run low involves more handling and counting and risks of loss. If checks are considered as cash, the risks of bad checks, insufficient funds, step payment orders, and stolen checkbooks are considerable. If a check guarantee contract is obtained, this costs more money. And in many cases, a merchant can have the use of funds more rapidly by depositing credit card slips obtained through a bank card system than by depositing checks on a distant bank, which must go through a long clearance process.

All these expenses resulting from handling cash might well be allocated to cash customers and passed on to them. Certainly they serve as a substantial counterbalance to the view that the discount paid to the merchant bank should be passed on to the card user.

Another reason why the tempting allocation of the merchant's discount to card users does not make good sense is that the merchant offers the card primarily as a device to attract customers so as to increase sales. The increase in sales, on which the merchant can make the usual substantial markup, far outweighs the significance of the small discount to the merchant bank, and the increase in business will enable the merchant to lower prices for all consumers.

A merchant accepting cards in order to attract customers, particularly customers from out of town who could not go to a local bank to take advantage of the cash discount, could not possibly expect to have such a customer buy anything with a card, knowing that the price to this consumer is higher than the price a cash customer will pay. A discount for cash, in fact, would keep all card using customers out of the store, and would eliminate the benefits of offering the card, except for customers who might succumb to this bait and switch approach.

Most reputable merchants, with the exception of automobile dealers, appear to prefer to set appropriate prices for their products or services, at which they can make a profit, and do not want to establish different prices for different customers or to bargain with customers for goods or services offered.

It may also be that merchants are fearful that by imposing a surcharge or giving a discount, and thereby adding a charge for credit to what the card issuer charges, they may subject themselves to usury complaints. Knowing, as they must, that card issuers usually impose interest rates at the maximum permitted by law, they must know that any additional charge for credit will mean that the customer is paying usurious rates, even if the amounts are divided between two creditors. Even if their lawyers assure them that they would not violate the usury statues, reputable merchants might well be reluctant to engage in such a practice.

In my view, there are many sound and convincing reasons why most merchants have decided not to give discounts for cash. I expect that these reasons would continue to keep them from giving discounts for cash, even if the amount that could be given without counting as a finance charge should be increased above five percent, or even if the same deceptive treatment should be given to surcharges for use of a card.

If this is correct, the proposed amendments might have little or no effect. The hopes of those who think cash discount programs benefit consumers would not be realized, nor would my concern that failure to treat the amounts of cash discounts or the amounts of surcharges as finance charges deceives consumers and frustrates the purpose and policy of the Truth in Lending Act.

If a consumer has purchased property or services with a credit card in the consumer's home state or within 100 miles of the consumer's mailing address, and the consumer has found the property or services defective and has tried to return the property to the merchant or to get the merchant to correct the problem, the consumer may refuse to make any further payment for the property or service, leaving the merchant the opportunity to sue the consumer. This statutory exception to the former waiver of defense provision contained in all card issuer contracts was inserted for the benefit of consumers.

If a consumer takes advantage of the cash discount offered by a merchant, the consumer will not have the benefit of this self-help claim and defense provision. It is not easy to say how much the loss of this benefit would prejudice a consumer who took the cash discount. It would depend on the quality of the property or services, and on the merchant's willingness to correct faults without compulsion.

In any event, it would seem desirable to bring this result of a cash discount program to the attention of consumers. Merchants would, of course, welcome this result, if they had adopted a policy of not correcting faults on a voluntary basis.

I trust these comments will be helpful to you and the other members of the Subcommittee and the Committee. If there are any questions about these comments, or if I can supply any further information, I should be glad to hear from you.

Respectfully submitted,

MATTHEW HALE.

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