MERCATUS CENTER
GEORGE MASON UNIVERSITY

March 28, 2005

SUBMITTED VIA E-MAIL: regs.comments@federalreserve.gov

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

***Re**: Docket No. R-1217 "Proposed Reforms to Federal Reserve Regulation Z Implementing the 'Truth in Lending' Act"*

Dear Ms. Johnson:

Please find enclosed comments on the "Proposed Reforms to Federal Reserve Regulation Z, Implementing the 'Truth in Lending' Act" that we have prepared in response to an Advance Notice of Proposed Rulemaking request for comment dated December 8, 2004 *(Federal Register,* Volume 69, No. 235, p. 70925).

The Regulatory Studies Program (RSP) of the Mercatus Center at George Mason University is dedicated to advancing knowledge of regulations and their impact on society. As part of its mission, RSP produces careful and independent analyses of agency rulemaking proposals from the perspective of the public interest. This comment on the Reg Z Advance Notice of Proposed Rulemaking does not represent the views of any particular affected party or special interest group, but is designed to evaluate the effect of the proposed rule on the public interest generally.

The Regulatory Studies Program appreciates the opportunity to comment on the proposed rule. We hope that consideration of these comments will enhance the quality and development of regulations and policy regarding alternative privacy notices.

Susan E. Dudley, Director
Regulatory Studies Program

3301 North Fairfax Drive, Arlington, VA 22201
703.993.4930 http://www.mercatus.org

MERCATUS CENTER
GEORGE MASON UNIVERSITY

PUBLIC INTEREST COMMENT

Proposed Reforms to Federal Reserve Regulation Z Implementing the "Truth in Lending" footnote[1]

The Regulatory Studies Program (RSP) of the Mercatus Center at George Mason University is dedicated to advancing knowledge of the impact of regulation on society. As part of its mission, RSP conducts careful and independent analyses employing contemporary economic scholarship to assess rulemaking proposals from the perspective of the public interest. Thus, this comment on the Federal Reserve's Review of Regulation Z (or "Reg Z"), does not represent the views of any particular affected party or special interest group, but is designed to evaluate the effect of the proposals on overall consumer welfare.

This comment is organized such that Section I introduces the proposed rule. Section II provides some background information on the consumer credit market and the effectiveness of Reg Z at increasing consumer awareness of credit terms. Section III considers the Board's detailed requests for comment on particular aspects of the rule. Section IV includes some suggestions for further research regarding consumer credit, and Section V concludes.

I. Introduction

The Board of Governors of the Federal Reserve System periodically reviews its regulations with an eye toward updating them as necessary. The Federal Reserve's Regulation Z implements provisions of the 1968 *Consumer Credit Protection Act,* more popularly referred to by the *Act's* Title 1, "Truth in Lending" (or "TILA"). Although the *Act* was significantly amended in 1980 and various parts of the implementing regulations have been modified since then, this is the first time since 1982 that Regulation Z has been reviewed in its entirety. footnote[2]

The Federal Reserve's current review focuses on the disclosure requirements for open-end or revolving credit accounts not secured by a home. In other words, the review covers consumer credit card accounts, both merchant-specific cards and general-purpose bankcards such as VISA and MasterCard. The Fed plans to review other credit facilities under Regulation Z (such as home mortgages) later.

footnote[1] Prepared by Jay Cochran, III PhD, Senior Research Fellow, Regulatory Studies Program. This comment is one in a series of Public Interest Comments from Mercatus Center's Regulatory Studies Program and does not represent an official position of George Mason University.

footnote[2] The Board of Governors announced an advance notice of proposed rulemaking, *Federal Register 69*, 235, (December 8, 2004) pp. 70925-70936, that begins a review process of the revolving credit disclosure requirements of Regulation Z. Hereafter referred to as the "proposed rule" or "ANPR." Docket No. R-1217.

A. **Purpose and Scope of the Regulation Z**

The original rationale for Truth in Lending requirements was to "assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit." (Section 102 of the *Act*) The *Act* is also intended to provide substantive and procedural protections—in addition to disclosure requirements—by prohibiting inaccurate and unfair credit billing and certain credit card practices.*footnote*[3]

B. **Disclosures**

Providers of consumer revolving credit must disclose the cost of credit and other credit terms: (1) when customers are initially solicited (and disclosure requirements can vary depending on the type of solicitation method used); (2) when an account is opened and before the first transaction occurs; (3) on monthly statements; and (4) on an as-needed or ad hoc basis when account terms or costs change.*footnote*[4]

C. **Substantive and Procedural Protections**

The *Truth in Lending Act* and Reg Z also require consumer protections that provide: (1) procedures for resolving billing errors; (2) procedures for resolving disputes related to the quality of goods or services purchased with a credit card; (3) a $50 cap on consumer liability for unauthorized use of a credit card; (4) card issuers may only issue a card after receiving a consumer request; and (5) payments must be promptly credited to a consumer's account upon receipt.*footnote*[5]

II. Background

A. **Size of the Open-End (Revolving) Consumer Credit Market**

Since the inception of the regulations, the nominal dollar amount of revolving consumer credit has grown from $3.7 billion in January 1970 to over $820 billion as of December 2004. The real dollar amount of revolving credit has grown at a compound annual rate of 11.2 percent.*footnote*[6] By comparison, real home mortgage debt of US households (including home equity lines of credit) grew at a 5.1 percent annual rate over the same period, and real GDP grew at a 3.2 percent compound annual rate. In real terms then, revolving consumer credit grew three and one-half times faster than gross domestic product and more than twice as fast as home mortgage debt.

In terms of household balance sheet composition, revolving consumer credit's share of total household liabilities has risen from less than one percent in 1970, to nearly

footnote[3] See ANPR, *Federal Register*, pp. 70927-70928.

footnote[4] *loc. cit.*

footnote[5] *loc. cit.*

footnote[6] Nominal volumes of revolving credit outstanding taken from Federal Reserve Statistical Release G19, "Consumer Credit." Nominal values were deflated by the Consumer Price Index, Urban Consumers (CPI-U, 1984=100) from the Department of Labor, Bureau of Labor Statistics. http://www.bls.gov Real GDP data from. http://www.bea.gov/bea/dn/nipaweb/SelectTable.asp?Selected=N (Department of Commerce, Bureau of Economic Analysis).

8 percent of all outstanding household liabilities currently. This compares to the growth of home mortgage debt, which went from 60 percent of household liabilities in 1970, to 70 percent as of 2004footnote[7]

B. **Effectiveness of the Rule**

Can the absolute growth of revolving debt over the last forty years be attributed, at least in part, to the disclosures required under Truth in Lending? A *lack* of awareness of credit's cost seems likely to generate greater uncertainty among potential borrowers. Other things equal, greater uncertainty should militate against increases in credit balances inasmuch as uncertainty operates as an effective increase in credit's cost versus circumstances where cost is known with greater certainty. On the other hand, greater awareness of the actual cost of consumer credit may induce some consumers to borrow less if the actual cost is higher than what they had anticipated.

By removing or at least reducing the uncertainty of costs and terms of consumer credit usage, the disclosures required under Truth in Lending regulations seem to have lead to more efficient use of credit by consumers. As Durkin suggested, Truth in Lending disclosures may lead "…some consumers [to] use less credit after the introduction of expanded disclosures if the required information persuades them that credit is expensive. Others may not change their use of credit at all or might even increase their credit use if the required disclosures either confirm their previous view that credit is affordable, or increase their confidence that using credit is a desirable option."footnote[8]

One thing, however, seems clear: disclosures have correlated positively with improved consumer awareness of credit costs. Survey data seem to support the inference that Truth in Lending disclosures have increased consumer awareness of credit costs. According to Durkin (2002: p. 206), consumer awareness of credit card annual percentage rates has "increased from 27 percent of credit card holders before Truth in Lending, to 63 percent in 1970 (fifteen months after implementation), to 71 percent in 1977, and in 2000 to 85 percent and 91 percent respectively, for the 'narrow' and 'broad' definitions of awareness employed in the 2000 survey."footnote[9]

Given improved awareness, and thus some support for the inference that uncertainty has been reduced, coupled with the rapid growth in consumer credit, Durkin's hypothesis of increased confidence and better understanding of affordability seems to

footnote[7] Data on household liabilities and home mortgages taken from the Federal Reserve's Z.1 Statistical Release, "Flow of Funds Accounts of the United States," Table L.100 (Households and Non-Profit Organizations). See line 24 for Total Liabilities, and line 26 for Home Mortgages outstanding. http://www.federalreserve.gov/releases/z1/

footnote[8] Durkin, Thomas A. (2002), "Consumer and Credit Disclosures: Credit Cards and Credit Insurance," *Federal Reserve Bulletin*, April, pp. 201-213.

footnote[9] See Durkin (2002).

In the absence of more rigorous research, it may be incorrect to attribute all of the improvements in consumer awareness entirely to TILA and Reg Z. It is possible that improvements in awareness correspond with innovations in consumer credit and with greater acceptance of revolving credit usage, and the regulations are merely coincidental to those facts.

suggest that TILA disclosures at the margin may have played a contributing role in more vigorous use of revolving credit over the last forty years. The precise degree of that contribution, however, remains unknown. More will be said about this particular lack of knowledge below.

C. **Cost of Complying with the Rule**

Several studies of Truth in Lending regulations have focused on the degree to which the disclosures required under the *Act* correlate with improved consumer awareness of credit costs. Other studies have focused on the costs incurred by financial intermediaries to comply with the substantive, procedural, and disclosure requirements of TILA. Elliehausen (1998) provides a useful summary of the evidence so far amassed regarding the cost of bank regulations generally, including Truth in Lending.*footnote*[10]

Summarizing the results of two Grant Thornton studies that used banking data from 1991, Elliehausen (1998, Table 2, p. 15) reports that on-going operating costs*footnote*[11] of complying with TILA ranged from 1.73 percent to 2.26 percent of non-interest expenses of the commercial banks studied.*footnote*[12] If these same relationships still hold today, applying the mid-point of the two Grant Thornton estimates—or 2 percent—to current non-interest expenses of depository institutions suggests that TILA compliance costs averaged about $65,900 per depository institution in 2004.*footnote*[13] Applying the same percentage of non-interest expenses across all US banks and savings institutions produces a total cost estimate of complying with TILA of roughly $5.9 billion in 2004.*footnote*[14]

footnote[10] Elliehausen, Gregory (1998), "The Cost of Bank Regulation: A Review of the Evidence," *Staff Studies* (No. 171), Washington, DC: Federal Reserve System Board of Governors. http://www.federalreserve.gov/pubs/staffstudies/1990-99/ss171.pdf

footnote[11] Employee hours by position and/or department that were then translated into costs by applying standard salary, benefits, overhead, and other direct costs.

footnote[12] As cited in Elliehausen (1998), Grant Thornton (1992) "Regulatory Burden: Phase II—Field Cost Studies," Study prepared for the Independent Bankers Association of America, August-September 1992. See also Grant Thornton (1993) "Regulatory Burden: The Cost to Community Banks," Study prepared for the Independent Bankers Association of America, January 1993.

footnote[13] Data on non-interest expenses for banks and savings institutions taken from the FDIC's "Statistics on Depository Institutions" database, http://www2.fdic.gov/sdi/main.asp. As an alternative check on the estimate, simply grossing up the mid-point of average compliance costs in Grant Thornton (1992 and 1993) of $47,777 per institution at the prevailing rate of CPI increase generates an average per institution compliance cost of about $67,548.

footnote[14] These 2004 cost estimates must be treated cautiously as they are based on Grant Thornton case studies and surveys of a sample of banks, and were undertaken more than 10 years ago. Moreover, the distribution of compliance costs is highly skewed owing to economies of scale. (For more on economies of scale, see Elliehausen [1998], and in connection with an analysis of Truth in Savings requirements, see Elliehausen and Lowery [1997], "The Cost of Implementing Consumer Financial regulations: An Analysis of Experience with the Truth in Savings Act," *Staff Studies*, Washington, DC: Federal Reserve Board of Governors, http://www.federalreserve.gov/pubs/staffstudies/1990-99/ss170.pdf. Both papers note significant economies of scale in regulatory compliance costs.)

The 1992 Grant Thornton case study (based on 1991 bank data) evaluated compliance costs at nine community banks, which tend to be comparatively small institutions in terms of asset size. The 1993 Grant Thornton survey (also based on 1991 bank data), on the other hand, asked 2,600 independent banks

III. Requests for Detailed Comment

The Fed asks (pp. 70929-70933 and *passim)* several dozen specific questions about the current rule such as:

- The appropriate formatting and presentation rules that disclosures should be required to take;
- The effectiveness of the "Schumer Box" as an awareness tool;
- What improvements can be made to readability;
- How do consumers learn about fees imposed by creditors;
- What significance to consumers attach to the label "finance charge" versus "fee" or "charge;"
- Is a 15-day advance notice by mail timely; and
- Do sub-prime or secured accounts warrant special treatment for disclosures?

While the Board is to be applauded for its thoroughness, the degree of specificity itself speaks to a basic intractability of its regulatory problem: Namely, that in a credit universe characterized by diverse consumer preferences and budgets, as well as by rapid innovation both within and around the regulated industry, it is highly unlikely that any regulatory regime will remain stable—that is, capable of securing desired outcomes for any significant length of time. The net result of this general observation is that the specific changes on which the Fed seeks comments are unlikely to yield better-informed credit consumers beyond where those consumers are now. However, any changes instituted because of this ANPR are likely to impose substantial incremental costs on the consumer credit intermediation process.

The myriad (proposed) changes represented by this ANPR have the potential to be quite costly for several reasons. (a) The current rule appears to be in the very costly stages of diminishing returns (i.e., the Pareto principle likely applies); (b) large-scale changes can be preferable to many small changes assuming an either-or trade-off; and (c) innovation necessarily upsets the regulatory balance rendering it unstable.

footnote 14 continued about compliance costs incurred on a number of regulations including Truth in Lending. The larger 1993 survey included a variety of independent banks of different asset sizes and thus may be more representative of actual compliance costs industry-wide. Moreover, the larger sample produced higher relative compliance costs (in relation to non-interest expenses) as compared to the narrower 1992 case study. Since the largest bank holding companies were presumably not included in either study, however, compliance costs may be understated to that extent—the precise degree of understatement depending on the extent of scale economies.

A. **At the point of diminishing returns (Pareto principle applies)**

Modified or enhanced disclosures may help to capture that remaining 10 percent or so of consumers who currently remain poorly informed about the (APR) cost of revolving credit. Clearly, however, the logic of diminishing returns suggests that trying to improve the understanding of that remaining 10 percent is likely to prove quite costly. In fact, if the Pareto principle applies here, then capturing that remainder of uninformed consumers may ultimately prove as costly as was capturing the first 80 to 90 percent of consumers who now consider themselves informed.[15]

B. **Frequency of rule changes**

Elliehausen (1998, p. 28) reports on findings that suggest start-up costs (i.e., those costs that must be incurred initially just to bring an institution into compliance, and is distinguished from on-going costs that periodically recur under a rule) tend to be insensitive to the volume of changes implemented in a modified rule mainly because of cost indivisibilities. Elliehausen deduces from this that "a regulatory policy of making frequent small changes in regulations may be more costly than one of making infrequent major changes." (p. 28) In other words, recurring costs continue to be incurred, but each rule change exacts some amount of incremental start-up costs on top of those recurring costs, making frequent changes more costly. Although the present ANPR is a large-scale overhaul of Reg Z, several small changes have preceded it since its last major overhaul in the early 1980s.

Elliehausen (1998, p. 28) reports on Boyle's (1983) findings in which Boyle attempted to estimate the cost of the major revisions to Reg Z that were implemented in the early 1980s.[16] Boyle's findings suggested that compliance costs rose by about 45 percent in the first year following the implementation of the major revisions. If the previous estimates of $5.9 billion in on-going costs are accurate, then Boyle's ratio suggests that start-up compliance costs to revolving credit providers may rise by an incremental $2.7 billion in the first year following imposition of the proposed changes suggested in the ANPR.

C. **Rules outmoded by innovation**

Part of the rationale offered for modifying Reg Z is to keep up with the myriad innovations in the consumer credit arena. Convenience checks, pricing structures that vary based on services provided (cash advances versus merchandise purchases, for example) or by the credit quality of applicants, penalty rates and fee structures for late payments, affinity and reward programs, are all factors that have the potential to make understanding the cost of credit more complicated for consumers.

Indeed, given these marketplace innovations, the Fed suggests that nearly one-third of respondents in a survey of consumers' perceptions about credit cards indicated

[15] The Pareto principle, or 80/20 rule, holds that 80 percent of results (or costs) tend to be generated by 20 percent of a given group.

[16] Boyle, John M. (1983), *A Survey of the Mortgage Banking Industry Concerning the Costs and Benefits of Regulations.* Washington, DC: US Government Printing Office.

that improvements could be made in the format and clarity of credit card account disclosures.[17] Is it, however, possible to design a notice system that can improve the format and clarity of disclosures, and thus satisfy that one-third of consumers, and do so, moreover, in a way that does not jeopardize the other two-thirds of consumers who are currently satisfied with disclosure? In general, under a system characterized by diverse preferences (for credit, credit costs, disclosures, etc.) and consumer budget sets, the timelier innovation provided by a marketplace response is more likely to produce the widest array of products and thus of consumer satisfaction than can be expected from a more regimented and proscriptive regulatory approach.

IV. Recommendations

Given competition among more than 8,000 U.S. banking institutions for consumers' credit business, to what extent would consumers and bankers have arrived at adequate disclosure levels on their own? Given the incentives on both sides, in other words, what prevents this information asymmetry from being resolved by individual consumers and bankers without regulatory intervention? To answer these questions, more thorough research into the connection between TILA and better (not just more-informed) use of consumer credit is warranted.

A. **Recommendations for Non-regulatory approaches**

Awareness of consumer credit costs is not an end in itself. Rather it should be a remedy to some actionable deficiency. We would recommend that the Fed's research agenda move beyond evaluations of awareness and into studying the effects of disclosure on consumers' credit behavior. In other words, does improved disclosure about credit costs and terms in fact lead to better decisions about and consumer use of credit?

i. *Does awareness of APRs lead to more efficient use of consumer credit?*

Although consumer awareness of credit costs has risen since the inception of TILA, since 1985 (the earliest date for which data are available), the relative rate at which revolving consumer credit accounts have been charged off by banks has also generally risen, as shown in Figure 1. Some increase in loan losses (i.e., charge offs) is to be expected during cyclical downturns, and these recessionary periods are indicated in Figure 1 with grey vertical bars. Following a recession's conclusion, loan losses decline as one might expect, but despite the cyclical nature of charge offs, the overall trend over the two decades shown in Figure 1 is clearly positive.

Have the disclosures required under TILA functioned like an implied quality signal, offering quiet reassurance to consumers that credit card debt is a relatively benign financial undertaking? From the opposite perspective, if a lack of awareness inhibits consumer use of credit, symmetry suggests that improved awareness may encourage or even stimulate its use. On the surface, such a conclusion is not unreasonable, and given

[17] See ANPR, p. 70927.

the trends in Figure 1, understanding the degree of TILA's contribution to this phenomenon is a question meriting further investigation.footnote[18]

Some work in this area has already been undertaken. According to Durkin, roughly one in five respondents to a consumer credit survey reported that Truth in Lending statements had affected their credit decisions (77 percent responded that TILA statements had not affected their decisions).footnote[19] Of those whose decisions were affected by TILA disclosures, about one quarter "said it made them more cautious in using credit." In other words, about 5 percent of consumers surveyed indicated that they had used credit more cautiously because of TILA requirements. By implication, therefore, about 14 percent of consumers increased their use of credit because "the required disclosures either confirm[ed] their previous view that credit is affordable or increase[d] their confidence that credit [was] a desirable option."footnote[20]

ii. *Do the regulations induce moral hazard among consumer borrowers?*

Therefore, it seems that for a majority of consumers who find TILA disclosures useful, the usefulness seems to be a means of reinforcing a favorable perception about the use of credit. The notices for some consumers, in other words, may be inducing a form of moral hazard. Certainly, the circumstantial evidence presented earlier supports the general inference that as awareness of consumer credit costs and terms has increased, so too has the degree of consumer default on revolving credit. To be sure, this positive relationship may not hold once more thorough and careful controls on determinants of the consumer credit decision are included, but the point here is that the general tendencies seem to be suggestive of an influence.footnote[21] Only more thorough research can more clearly answer the question.

footnote[18] Symmetry also suggests that, as in note 9 above, the increase in charge offs that correlate with more TILA disclosures and better consumer awareness may be coincidental as well.

Following Stigler (1961), credit consumers may be thought of as balancing the marginal costs and benefits of additional information in their use of revolving credit. By standardizing the presentation of credit costs and terms and by other means, TILA disclosures ought to decrease the marginal costs to consumers of obtaining the next increment of information. From this marginal cost perspective, moreover, TILA disclosures ought to contribute unambiguously to efficiency. However, what has been TILA's impact on the marginal benefit side? In general, one marginal benefit of consumer credit is to shift consumption patterns toward the present. To the extent, however, that this temporal shift is also accompanied by a more than proportional increase in charge offs (defaults), then the marginal benefit of enhanced disclosure is reduced to that extent. The size and relative importance of these influences is not well known and would benefit from further research. See Stigler, George J. (1961), "The Economics of Information," *The Journal of Political Economy 69* (3): pp. 213-225.

footnote[19] Durkin (2002), *op. cit*., p. 207.

footnote[20] *loc. cit.* 77 percent of respondents to 2001 Survey by the National Commission on Consumer Finance indicated the TILA statements had not affected decisions to use credit cards, while 18 percent indicated that the statement had affected their decisions in some way. Five percent did not know. Of the 18 percent who said TILA affected their credit decision, "about half said that it helped in deciding whether to obtain a card and in choosing which card. A bit more than one-fourth of [the 18 percent] said that it made them more cautious." *Op .cit.*

footnote[21] As already mentioned, TILA disclosures my operate as a quiet or implied quality signal to consumers, which may in turn allow them to be less vigilant about revolving credit use than they otherwise

iii. *How do the regulations affect efficient intermediation?*

Another question related to Truth in Lending is to what extent TILA requirements inhibit efficient financial intermediation. In other words, compliance costs (to the extent they exceed the costs intermediaries would incur to inform their credit customers in the absence of regulation) as well as the other requirements of TILA (such as caps on consumer liability) all change constraints faced by participants in the consumer credit market, and therefore, consumer and intermediary behaviors change also. Are these regulation-induced behavioral changes efficient or do they impose deadweight losses?footnote[22]

In addition, to the extent TILA requirements raise costs to financial intermediaries that must be recovered, to what extent (if any) do the regulations aggravate the problem of the "unbanked poor?" In other words, if the TILA requirements result in an increase in the marginal costs for banks, then the increase in costs will price some demanders of bank services out of the market. If this is so, to what extent are regulatory costs (such as those associated with TILA) channeling people away from the banking system rather than encouraging their use of the system?

iv. *Cost of Revolving Credit*

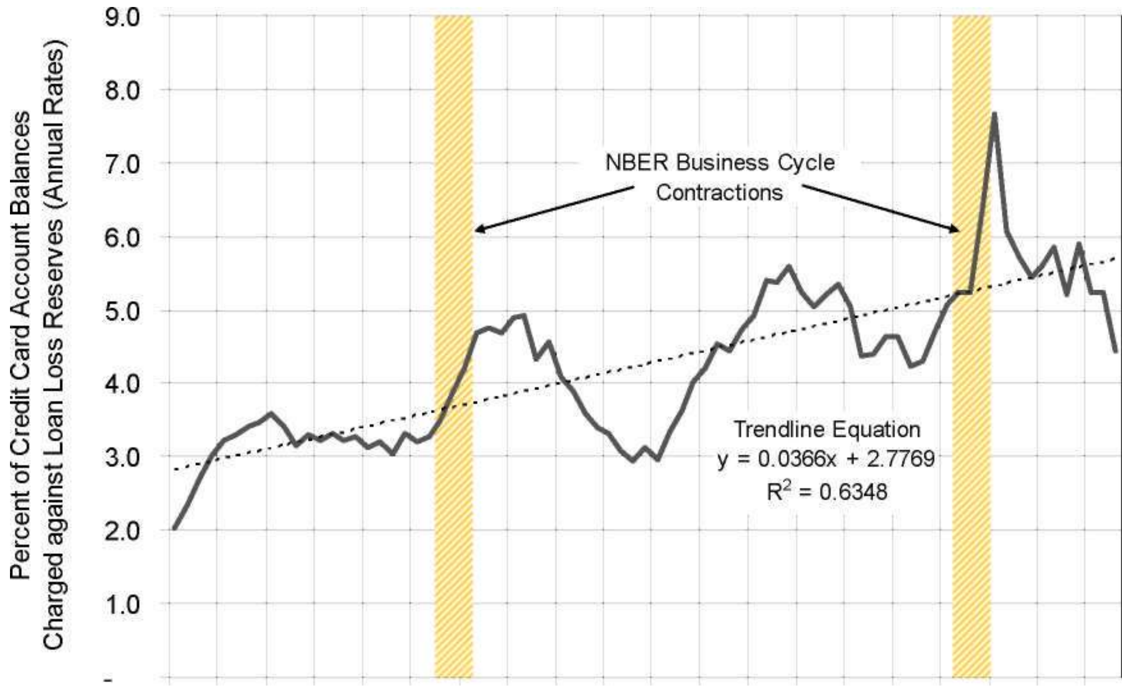
By reducing a potential information asymmetry, TILA disclosures ought not only to foster better understanding among consumers, but should also foster heightened competition among consumer revolving credit suppliers as consumers use their improved information position to shop for better rates among potential lenders. Other things equal, therefore, enhanced awareness of consumer credit costs ought to lead to lower spreads for revolving credit versus other forms of consumer credit. Again, on the surface, for most of the period since enactment of TILA and Reg Z, however, despite better appreciation of credit costs among consumers, revolving credit has remained higher in cost both relatively and absolutely than other forms of consumer credit, such as traditional installment loans.footnote[23] To what degree if any has improved consumer awareness facilitated or retarded competition and marketplace adjustments among suppliers and demanders of revolving credit accounts?

footnote 21 continued might. In this, government-required disclosures may function somewhat analogously to deposit insurance by inducing less vigilance among bank customers. Moreover, the fact that one-third of consumers surveyed by the Fed believe that TILA notices can be improved for clarity and readability seems to suggest that some important fraction of consumers are not as clearly informed as other measures of awareness seem to indicate but nevertheless manage to use consumer credit anyway.

footnote[22] While the costs of complying with TILA measure in the billions of dollars, these costs still represent a fraction of the amount of net debt issued in 2004. Total US bank assets grew by nearly $700 billion in 2004, while the entire volume of outstanding credit grew by nearly $2.0 trillion (see the Federal Reserve's Z.1 Statistical Release). Still, to the extent TILA raises costs to banks and other credit intermediaries beyond where it would have otherwise been, the potential for inducing deadweight losses (and transfers) still exists.

footnote[23] Anecdotally, however, some consumers have been able to negotiate reductions in credit card APRs with their individual credit card issuers (or to take balances to lower APR competitors). How widespread this practice is and the extent to which TILA disclosures have played a facilitating role in the renegotiation process are unknown.

FIGURE 1
Consumer Credit Card Charge-Off Rates by Banks



Source: Federal Reserve Board, Statistical Release on Charge-Off Rates

V. **Conclusion**

While wanting to update regulations to take account of new innovations in consumer credit offerings is understandable, the current implementation of Regulation Z appears to be near the point of diminishing returns—at least insofar as improving required disclosures is concerned. Sweeping changes to the rules that are proposed are likely to generate significant costs for credit providers (of at least an additional $2.7 billion in the first year of the changes) while providing little improvement in consumer understanding of credit terms.

We suggest in the alternative that a better use of resources might be for the Fed to study more thoroughly the connection between improved consumer awareness of credit terms, consumer usage of revolving credit, and Reg Z's incremental impact on either or both items. Without this knowledge, the U.S. runs the significant risk of imposing more costly regulation with little or no corresponding benefit offset.

Appendix I
RSP Checklist

Element	Agency Approach	RSP Comments
element 1. Has the agency identified a significant market failure?	Some consumers remain poorly informed about credit terms, and one-third of consumer survey respondents indicated TILA notices could be improved for clarity. The Fed seeks to improve notice to improve clarity and capture the uninformed. **Grade: C**	Innovation in the consumer credit marketplace is naturally outmoding regulations, though this is not necessarily a market failure. To inform the remaining 10 percent or so of consumers who are currently poorly informed is likely to be disproportionately costly.
element 2. Has the agency identified an appropriate federal role?	The *Truth in Lending Act* grants the Fed authority to promulgate regulations that implement the purposes of the *Act*. **Grade: A**	Since the passage of the *National Bank Act of 1864* and the *Federal Reserve Act of 1913* (as well as other laws), regulation of national banks has been a federal (and Federal Reserve) responsibility.
element 3. Has the agency examined alternative approaches?	The ANPR asks for alternatives to the current regulatory regime including eliminating outmoded regulations. **Grade: C**	The Fed has not offered its own independently developed alternatives to simple command-and-control regulation.

Element	Agency Approach	RSP Comments
element 4. Does the agency attempt to maximize net benefits?	agency approach No. **Grade: F**	rsp comment Very little explicit consideration of costs or benefits.
element 5. Does the proposal have a strong scientific or technical basis?	agency approach The *Act* and the rules have a basis in information asymmetry arguments. **Grade: C**	rsp comment The improvement in potential information asymmetries is not balanced against diminishing marginal returns to further regulation. The Fed establishes no connection between improved consumer awareness of credit terms and "better" use of consumer credit, nor does it recognize that competitive forces may resolve potential information asymmetries.
element 6. Are distributional effects clearly understood?	agency approach No active consideration given to distributional effects on bankers or credit consumers. **Grade: D**	rsp comment Economies of scale indicate distributional cost differentials in consumer credit provisioning. In addition, increases in compliance costs may aggravate the problems of the "unbanked poor."
element 7. Are individual choices and property impacts understood?	agency approach Agency proceeds from the aggregate level, relying predominately on survey instruments of unconstrained consumer preferences. **Grade: D**	rsp comment Given competition among 8,000 banking institutions for consumers' credit business, to what extent would consumers and bankers have arrived at adequate disclosure levels on their own? Given the incentives on both sides, in other words, what prevents this information asymmetry from being resolved by individual consumers and bankers without regulatory intervention? More thorough research into the connection between TILA and better (not just more-informed) use of consumer credit is warranted.