

Statement by Governor Randall S. Kroszner
May 23, 2007

Mr. Chairman and fellow members of the Board, I am delighted to introduce for your consideration an important and innovative proposal to improve the effectiveness of information provided to consumers who apply for, and use, open-end (revolving) credit. The proposal would amend Regulation Z, which implements the Truth in Lending Act.

Information is critical to the effective functioning of markets. A core principle of economics is that markets are more competitive, and therefore more efficient, when accurate information is available to both consumers and suppliers. When information on alternatives is readily available, product offerings will have to meet customers' demands and offering prices will have to reflect those of market competitors. In addition, information helps individual consumers by improving their ability to compare products and to choose those that will help them meet their personal goals.

These arguments are not just theoretical. There is systematic evidence that, in practice, changes in disclosure affect both consumer and supplier behavior in a number of consumer product markets and can bring benefits that enhance competition and consumer welfare. I believe that the changes we are proposing today bring such benefits. Better credit disclosure permits better-informed credit decisions and, hence, more effective competition among credit card issuers. In a nutshell, effective disclosure empowers consumers and enhances competition.

An important and novel feature of the proposal before us today is that it is based on extensive consumer testing, that is, asking real people what is useful and understandable to them. Although the Board has used consumer focus groups in the past, this is the first time that we have conducted comprehensive in-depth interviews with individual consumers. Not only did we ask consumers, but, as I think you will see in the details of our proposal, we have listened.

Our goal is to take a complex credit product and design disclosures that can explain the terms not only accurately but also clearly enough to be meaningful and useful to consumers--all while enhancing, not stifling, competition and innovation. The proposal is intended to balance potential benefits to consumers with compliance burden.

Based on our consumer testing, for example, the proposal would introduce format requirements for disclosures provided at account-opening and when terms change. Currently, a summary table of key terms accompanies credit card applications, which consumers recognize and find useful. Improvements are proposed to the application summary table (the “Schumer box”) to enhance its usefulness, and those design features are carried forward to summaries of key terms at account-opening. Our testing confirmed that consumers do not notice disclosures when they are interspersed among the dense legalese of credit contracts. The goal of the proposed revisions is to bring greater clarity of key terms on credit card accounts, to enable consumers to evaluate offers more easily and use their cards more wisely and enhance competition in the market.

The proposal clarifies and simplifies rules for disclosing fees by identifying precisely what fees creditors need to disclose at account-opening, and provides flexibility--with safeguards--for disclosing other fees at a time when the information may be more useful to consumers. This would address concerns about aspects of the rules that have made compliance difficult or uncertain by providing bright lines about how to treat specific fees.

The proposal also tackles an issue about which there has been much debate: the utility of the “effective” APR that appears on periodic statements and reflects fees as well as interest. The effective APR can be quite high because the calculation assumes that fees are amortized over one billing cycle. Our consumer testing showed that presenting the disclosure in a meaningful way is challenging, but we developed an improved format that shows promise and we will continue to do testing on this. The proposal also seeks comment on an alternative approach that would eliminate the requirement for the effective APR.

At this point, I will turn the proceedings over to Sandy Braunstein, the Director of our Division of Consumer and Community Affairs, and her staff who have done what I believe is a superb job in implementing a new approach to improving consumer credit disclosures based on extensive consumer testing with real people. Later today, I will give a speech outlining some of the general lessons we have learned from consumer testing that will inform our review of other areas of consumer disclosure, such as in the mortgage market.