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ABSTRACT

Individuals and organizations administering consumer credit services are urged to adopt the following recommendations and the Code of Billing and Collection Practices (also included): (1) Credit grantors should support continuing educational programs at national and local levels on the nature of the consumer credit system. (2) Whenever possible, credit granting systems should avoid passing costs on to non-credit users. (3) Credit grantors should continue to use ability and willingness to repay as the principal determining factors in decisions relating to the extension of credit. (4) Consumer credit granting criteria should be the same for men and women. (5) Credit grantors should update customer credit ratings on a regular basis, or upon request. (6) Credit rating systems should not unfairly discriminate between types of income. (7) Credit grantors should support the establishment of professional credit counseling services for consumers. (8) The states should use the uniform consumer credit code as the basis for modernizing their consumer credit statutes. (9) Government agencies at all levels should avoid actions which unnecessarily erode consumer credit information systems. (10) Credit grantors should develop, support, and encourage consumer educational programs on personal money management. (11) Financial institutions should avoid financing the purchase of products or services sold by unethical merchants. (Committee reports on which these recommendations were based are presented in Part II, a related document.) (JT)

Financing the American Consumer

A Business Report on Consumer Credit
Part I—Summary Report

Report of the Sub-Council on Credit and
Related Terms of Sale of the
National Business Council for Consumer Affairs

November 1972

This report contains the results of studies by an Advisory Committee. It does not necessarily represent the views of the Department of Commerce or any other Federal Government Agency.

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Executive Secretary: **Paul T. O'Day**
Deputy Director
National Business Council for Consumer Affairs
U.S. Department of Commerce

Honorable Peter G. Peterson
Secretary of Commerce
Washington, D.C. 20230

Dear Secretary Peterson:

We respectfully submit for your consideration the attached report, "Financing the American Consumer", prepared by the Sub-Council on Credit and Related Terms of Sale of the National Business Council for Consumer Affairs.

As the report notes, consumer credit is an essential service provided in the American marketplace. In using this service, consumers have the right to find efficiency and fairness at every point. The Sub-Council's analysis and recommendations have been drawn within this context.

The report focuses on a number of recommendations which, if adopted, would improve the Nation's system of consumer credit. We urge that you bring these proposals to the attention of individuals and organizations involved with operating and administering consumer credit services. In addition, we hope you will take steps to see that the specific recommendations contained in the report are implemented as widely as possible.

Sincerely,

Robert E Brooker

Robert E. Brooker, Chairman
National Business Council for
Consumer Affairs

Arthur E Rasmussen

Arthur E. Rasmussen, Chairman
Sub-Council on Credit and
Related Terms of Sale

Donald S. Perkins, Co-Chairman
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James D. Farley

James D. Farley, Vice-Chairman
Sub-Council on Credit and
Related Terms of Sale

Summary

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The credit marketplace is a complex arena, but, from the consumer's viewpoint, there are a number of opportunities for improvement which do not require highly technical analysis. This report seeks to identify some of these opportunities.

At the outset, the following action is called for on the part of credit grantors to assure that the public is informed on credit issues:

6 **RECOMMENDATION 1**

CREDIT GRANTORS SHOULD SUPPORT CONTINUING EDUCATIONAL PROGRAMS AT NATIONAL AND LOCAL LEVELS ON THE NATURE OF THE CONSUMER CREDIT SYSTEM.

As an example of a need for this activity, many individuals unreasonably use the corporate "prime rate" as a benchmark for fair consumer credit finance charges, a conclusion which bears no relationship to the reality of consumer credit costs.

In allocating the burden for consumer credit costs, credit grantors should adopt this principle:

11 **RECOMMENDATION 2**

WHENEVER POSSIBLE, CREDIT GRANTING SYSTEMS SHOULD AVOID PASSING COSTS ON TO NON-CREDIT USERS.

In addition, rates for the use of credit should be related to the cost of serving that class of users.

Credit exists in sufficient amounts for all but some low-income consumers. To assure that credit granting decisions are fair, corporations should observe the following in the administration of consumer credit:

12 **RECOMMENDATION 3**

CREDIT GRANTORS SHOULD CONTINUE TO USE ABILITY AND WILLINGNESS TO REPAY AS THE PRINCIPAL DETERMINING FACTORS IN DECISIONS RELATING TO THE EXTENSION OF CREDIT.

In addition,

12 **RECOMMENDATION 4**

CONSUMER CREDIT GRANTING CRITERIA SHOULD BE THE SAME FOR MEN AND WOMEN. WHEN THEY MEET THESE CRITERIA, MARRIED WOMEN WHO SO REQUEST SHOULD BE GRANTED CREDIT IN THEIR OWN NAME.

Also, to assure the widest availability of consumer credit,

Page

RECOMMENDATION 5 13

CREDIT GRANTORS SHOULD UPDATE CUSTOMER CREDIT RATINGS ON A REGULAR BASIS, OR UPON REQUEST.

In establishing rating criteria under any of these principles, credit grantors also should observe the following:

RECOMMENDATION 6 14

CREDIT RATING SYSTEMS SHOULD NOT UNFAIRLY DISCRIMINATE BETWEEN TYPES OF INCOME.

This recommendation is particularly important in view of the continuing growth in income supplements, welfare, unemployment and hospitalization payments, pensions, and other income subsidies.

Credit grantors also have the responsibility to provide sound professional advice to customers on the use of credit, therefore:

RECOMMENDATION 7 14

CREDIT GRANTORS SHOULD SUPPORT THE ESTABLISHMENT OF PROFESSIONAL CREDIT COUNSELING SERVICES FOR CONSUMERS.

This is particularly important for customers with lower incomes, or those seeking to use consumer credit for the first time.

Consumer credit availability could also be broadened somewhat through adoption of the following recommendation:

RECOMMENDATION 8 15

THE STATES SHOULD USE THE UNIFORM CONSUMER CREDIT CODE AS THE BASIS FOR MODERNIZING THEIR CONSUMER CREDIT STATUTES.

The free credit market and the reduction in detailed state regulation provided for in the Uniform Consumer Credit Code, would result in an increase in the supply of credit at all levels.

To effectively administer consumer credit systems, credit grantors need reliable consumer credit information. Thus, Page

16 **RECOMMENDATION 9**

GOVERNMENT AGENCIES AT ALL LEVELS SHOULD AVOID ACTIONS WHICH UNNECESSARILY ERODE CONSUMER CREDIT INFORMATION SYSTEMS.

Personal privacy against unauthorized use of credit information, and its accuracy, must be guaranteed, but operation of a rational consumer credit system would be impossible without pertinent credit data.

Consumer credit education is also important, therefore:

17 **RECOMMENDATION 10**

CREDIT GRANTORS SHOULD DEVELOP, SUPPORT, AND ENCOURAGE CONSUMER EDUCATIONAL PROGRAMS ON PERSONAL MONEY MANAGEMENT.

The credit grantor who finances the purchase of products or services through merchants should see that he is informed about those firms he is indirectly supporting:

18 **RECOMMENDATION 11**

FINANCIAL INSTITUTIONS SHOULD AVOID FINANCING THE PURCHASE OF PRODUCTS OR SERVICES SOLD BY UNETHICAL MERCHANTS.

Once the consumer has access to the consumer credit system, his primary complaints involve billing and collection practices. All credit grantors should adopt policies in these areas which serve the consumer promptly and fairly, including:

CODE OF BILLING AND COLLECTION PRACTICES

(Summary)

See page 23 for complete code

1. CREDITORS SHOULD FULLY EXPLAIN TO THEIR CUSTOMERS THE TERMS OF ANY LOAN OR OTHER CREDIT TRANSACTION.
2. CREDITORS WHO MAIL BILLS TO CUSTOMERS SHOULD DO SO AS SOON AS POSSIBLE AFTER THE BILLING CYCLE ENDS—AT LEAST TWO WEEKS BEFORE THE NEXT PAYMENT IS DUE.
3. CALLS OR CORRESPONDENCE FROM A CUSTOMER CLAIMING AN ERROR IN BILLING SHOULD BE ACKNOWLEDGED PROMPTLY.

4. CONSUMER CREDIT COLLECTION PRACTICES SHOULD BE BASED ON THE PRESUMPTION THAT EVERY DEBTOR INTENDS TO REPAY, OR WOULD REPAY IF ABLE.
5. LATE CHARGES SHOULD BE ASSESSED ONLY TO THE EXTENT NECESSARY TO RECOVER OVERALL EXPENSES CAUSED BY THE DELINQUENCY.
6. CUSTOMER COMPLAINTS CONCERNING COLLECTION PRACTICES SHOULD BE INVESTIGATED IMMEDIATELY.
7. COLLECTORS SHOULD BE INSTRUCTED TO ATTEMPT TO INITIALLY DETERMINE THE CAUSE OF THE DELINQUENCY AND TO INDICATE WILLINGNESS TO ARRANGE A MUTUALLY SATISFACTORY REPAYMENT SCHEDULE, WHEN APPROPRIATE.
8. CUSTOMERS WHO SHOW A SINCERE DESIRE TO REPAY THEIR DEBT SHOULD BE OFFERED, IF NECESSARY, EXTENDED REPAYMENT SCHEDULES, REFINANCING ARRANGEMENTS, OR SIMILAR METHODS THAT WOULD HELP RE-ESTABLISH THEIR SOLVENCY.
9. IF THE CUSTOMER DOES NOT RESPOND TO AN OFFER TO HELP MAKE ALTERNATIVE ARRANGEMENTS, THE COLLECTOR SHOULD EXPLAIN THE SERIOUSNESS OF CONTINUING DELINQUENCY AND ADVISE THE CUSTOMER OF THE COURSES OF ACTION OPEN UNDER THE CONTRACT AND UNDER THE LAW.
10. WHILE COLLECTORS HAVE AN OBLIGATION TO DISCLOSE HONESTLY TO DEBTORS AND ENDORSERS THE REMEDIES THAT MAY BE INVOKED AGAINST THEM, LEGAL ACTION SHOULD NOT BE CITED UNLESS IT CAN AND WILL BE USED.
11. TELEPHONE CALLS SHOULD BE PLACED BETWEEN THE HOURS OF 8 A.M. AND 8 P.M. UNLESS OTHER TIMES ARE MORE CONVENIENT FOR THE CUSTOMER.
12. OUTSIDE COLLECTION AGENCIES, ATTORNEYS, PROCESS SERVERS, AND OTHER AGENTS EMPLOYED TO COLLECT DELINQUENT ACCOUNTS SHOULD BE FURNISHED WITH WRITTEN INSTRUCTIONS ON HOW CUSTOMERS ARE TO BE APPROACHED, WHICH PRACTICES ARE SANCTIONED AND WHICH ARE NOT.
13. CREDIT GRANTORS SHOULD BE PARTICULARLY CAREFUL IN HANDLING DELINQUENCIES DUE TO A CUSTOMER'S DISSATISFACTION WITH THE GOODS OR SERVICES FINANCED.

Contents

Foreword

This report has been prepared by the Sub-Council on Credit and Related Terms of Sale of the National Business Council for Consumer Affairs. The Council was established by executive order by President Nixon on August 5, 1971, to advise the Federal Government on actions which would benefit consumers. It is composed of over 100 business leaders and receives staff and administrative support from the U.S. Department of Commerce.

At its first session on August 5, 1971, the Council created seven working Sub-Councils covering a broad range of consumer issues including advertising, packaging, warranties, credit, product safety, servicing, and complaints. The report which follows has been prepared by the Sub-Council on Credit and Related Terms of Sale.

The mission statement adopted by the Council places emphasis upon "activities which assure value, satisfaction and safety in the goods and services provided to co...umers." Specifically, this includes an attempt to "identify and examine existing and potential consumer problem areas; seek pragmatic solutions; develop programs benefiting consumers; and advise the Federal Government whenever appropriate." Within this framework, the Sub-Council on Credit and Related Terms of Sale established committees in the following four areas to carry out its work:

- Role and Functioning of Consumer Credit
- Credit Availability
- Billing Procedures
- Creditor Remedies and Collection Practices

The reports of the four committees are contained in Part II, published as a separate volume. These studies provide the basis for the findings and recommendations contained in the Sub-Council's summary report, which comprises Part I of this publication.

The issues relating to consumer credit are often seen as complex and difficult for non-experts to understand. From the consumer's viewpoint, however, there are a number of problems and opportunities relating to credit which do not require

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highly technical analysis or understanding to point the way to improvements which should be made. This report seeks to identify some of these opportunities and to describe actions which should be taken in the consumer's interest. In framing these recommendations, the Sub-Council believes that the development of a habit of positive action by the private sector organizations involved is the most effective and constructive long-term approach to the resolution of most consumer problems.

The Sub-Council has attempted to reach conclusions and recommend action acceptable to all members. This report, therefore, represents a general consensus of the members, but all statements included are not necessarily supported by all members with the same degree of conviction.

I. Introduction

The practice of delayed payment granted to buyers by sellers is as old as commerce itself. It existed in rudimentary form among ancient societies. Promissory notes evidencing credit transactions were used in Babylon over 4,000 years ago and there was a widespread use of credit in ancient Greece and Rome. The purchase of goods on the installment method in a form similar to that used today apparently had its inception in England during the latter part of the eighteenth century.

Today, various forms of consumer loan credit, and to a lesser extent sales credit, are found in all free market developed countries. Nowhere, however, has consumer credit reached the proportions or significance that it currently maintains in the United States. The dimensions and complexities of the American consumer credit market touch the everyday lives of almost every citizen, so it is not surprising to find continuing demands for improvement.

"The dimensions and complexities of the American consumer credit market touch the everyday lives of almost every citizen, so it is not surprising to find continuing demands for improvement."

These demands are stated by professional consumer advocates, academicians, labor union spokesmen, and representatives of business. Their grievances relate primarily to rates of finance charge, billing procedures, collection practices, creditor remedies, rights of privacy, and the availability of credit.

Some claim that finance charge rates are too high and creditor remedies too harsh, while others contend that maximum finance charge rates set by law are too low and that available creditor remedies are too inefficient to enable credit grantors to serve the market with a reasonable rate of return. Other attacks are aimed at objectionable collection practices which offend the consumer's dignity and deprive him of an opportunity to be heard. And the failure to complete timely correction of routine billing errors draws criticism from many. Some also claim that credit is too readily available, encouraging over-extension and consumer bankruptcy, while others assert that credit granting criteria are too restrictive and that credit should be more freely available. New, more flexible, and more convenient forms of credit are sought, often

"Consequently, pressures are brought to bear simultaneously on the credit industry from conflicting points of view."

without understanding of the associated costs. In the meantime, all those consumers who invest their funds in the industry demand a satisfactory return on their investment. Consequently, pressures are brought to bear simultaneously on the credit industry from conflicting points of view.

There are legitimate and reasonable consumer grievances about the operation of the Nation's consumer credit system, and these should be corrected. Some of these changes are recommended later in this report. But the inviolable principle throughout is that credit grantors must obtain a reasonable return on their investment, or they will invest elsewhere.

In response to many of these issues, Congress established the National Commission on Consumer Finance to examine broadly the workings of the Nation's consumer credit system and recommend improvements. The Commission has undertaken a series of twenty specific surveys and studies, including an attempt to correlate finance charge rates and credit availability on a state-by-state basis, and a comparative analysis of state credit laws and their effects. For the first time, the Commission's studies will provide a major data base of nationwide information on consumer credit. The Commission's report is expected early in 1973.

In addition, business efforts to expand the use of voluntary complaint settlement mechanisms are found in the new Council of Better Business Bureaus and the newly established Consumer Affairs Center of the National Consumer Finance Association.

This report recognizes the existence of these companion organizations also seeking to resolve consumer problems within the Nation's credit system. As a result, the Sub-Council has not attempted to create original data on the issues at hand which would duplicate work underway in these organizations or elsewhere. The conclusions and recommendations found in this report are based on a general review of the field on consumer credit, with emphasis on known problems, and on solutions to these difficulties which can be instituted directly by companies and other organizations.

II. Consumer Credit in the American Economy

Consumers account for nearly seventy percent of total national income expenditures, and the level of consumer credit available to facilitate these purchases affects operation of the entire economy.

This credit enables individuals to make purchases, benefit immediately from their utility, and pay for them over a period of time. The use of credit often permits a transaction to occur which otherwise may not have been possible.

". . . credit enables individuals to make purchases, benefit immediately from their utility, and pay for them over a period of time."

Because of this, consumer credit has become an integral part of the fabric of American life. It has contributed substantially to the development of the U.S. economy and to the high standard of living enjoyed by most Americans. It has provided a necessary link for the economic and social transition from a rural, agrarian economy to the highly industrialized and urbanized system of modern times.

Consumer credit, in adding substantially to the buying power of consumers, has affected both the level and structure of consumer demand. This increased consumer demand, in turn, stimulates the production and distribution of goods and services on a mass scale, thereby providing greater employment opportunities, higher income levels, and lower unit cost to the consumer.

The amount of consumer credit outstanding in the United States at the end of 1971 exceeded $135 billion, compared with a figure of less than $6 billion in 1945. During this same period, consumer credit outstanding increased from less than four percent of personal disposable income to nearly twenty percent. This growth, by type of credit, is shown in Figure 1.

Many factors have contributed to the growth of consumer credit in these categories including:

- 1. Higher incomes,
- 2. A general increase in the standard of living,
- 3. An increase in the number and variety of consumer goods appearing on the market,
- 4. Wider acceptance of the principle of amortization of debts on the installment plan,

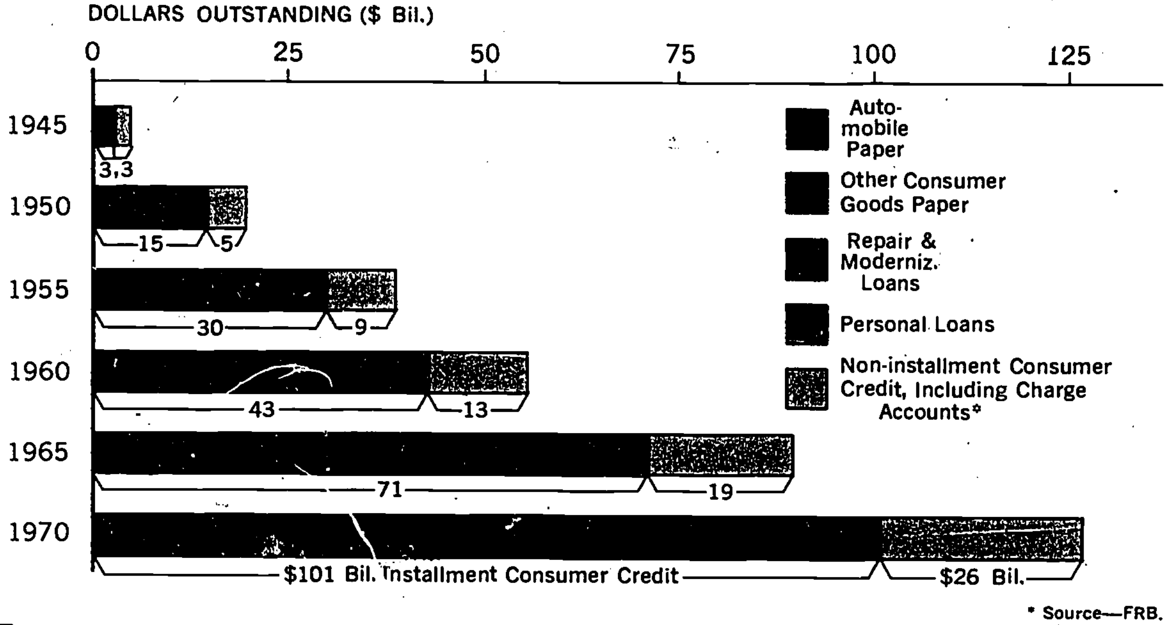


Figure 1. Growth of Consumer Credit

- 5. The extension of maturities of debt contracts,
- 6. A decrease in the size of required down payments,
- 7. A general increase of confidence in economic security, including retirement, unemployment, and disability income assurances
- 8. An increase in leisure time,
- 9. An increase in home ownership and its accompanying demand for household furnishings and appliances,
- 10. A large growth of the number of people between twenty and thirty years of age who traditionally have been heavy users of consumer credit,
- 11. The existence of retail and financial institutions competing actively for the consumer credit market, and
- 12. The creation of new forms of credit, such as credit cards.

"... the field of consumer credit is a shifting, changing system, responsive to new demands and new services subscribed to by consumers."

Thus, the field of consumer credit is a shifting, changing system, responsive to new demands and new services subscribed to by consumers. As a result, the structure of the consumer credit system has seen dramatic movement in market shares of the leading institutions in recent times.

In general, the selection of source and type of credit by a given consumer is the product of a complex set of factors. A variety of competing services are offered by the various types of credit grantors, giving the consumer the option of different means of purchasing for any single purpose. Thus, a consumer durable may be financed indirectly by a bank or sales finance company purchasing the consumer paper evidencing the debt. It may be purchased with the proceeds of a personal loan obtained from a bank, credit union, sales finance or consumer finance company, or it may be financed by the retail seller directly. And, in the case of the bank, the "loan" may be made in traditional fashion or, perhaps, through the use of a bank credit card or a check guarantee or overdraft plan. Most goods, on the other hand, may be acquired with the proceeds of a personal loan, in whatever form, by means of a retail charge account, credit card, or by some other form of credit plan.

Furthermore, traditional patterns of credit usage are being altered as a result of consumer demand for new credit services. There is, thus, increased use of credit for financing travel, entertainment, education and other service expenditures previously paid for in cash. Indeed, the growth of service credit has been greater than any other type of consumer installment credit in the 1960's. To meet this demand, new forms of credit services and credit extension were devised, the most important of which has been the credit card.

Notwithstanding these consumer options and shifts in structure, consumer credit does not operate in a totally free market. State legislation governs virtually all consumer credit operations, under a wide variety of individual legal systems. Typically, these prescribe who can participate in credit extensions and under what conditions. For example, some State laws cover:

- 1. Prohibitions for certain types of institutions, such as credit unions and savings and loan associations, in offering some credit services.
- 2. Limitation on the number of competitors within a given area.
- 3. Limitations on the amount, maturity, and rate of a loan which can be made by a particular type of credit grantor, or
- 4. Beneficial tax treatment for some types of lenders, for example, credit unions.

Beyond specific legal provisions, some consumer credit grantors enjoy advantages because of their position in the

"Notwithstanding these consumer options and shifts in structure, consumer credit does not operate in a totally free market."

system, e.g., banks may have access to funds for lending at lower cost than most competitors, or retailers and sales finance companies may retain an interest in the property sold and financed to their customers.

Thus, the national consumer credit "system" is an exceedingly complex web with a number of characteristics unique to its market. Restrictions which focus only on a limited aspect of credit extension, such as rates or creditor remedies, but which ignore effects on costs and revenues, can often produce results which run counter to other social goals. These complexities are not often understood by those who press for immediate change in the name of progress. In this setting, poorly conceived solutions to problems of the moment can have unexpected and harmful side effects to consumers themselves. This is especially true if those solutions are cast in laws and regulations which are difficult to apply flexibly, or to improve or correct by amendment should conditions change.

". . . poorly conceived solutions to problems of the moment can have unexpected and harmful side effects to consumers themselves."

Because of this situation, credit grantors have the continuing responsibility to encourage and provide the widest possible education on the nature of the consumer credit system, with emphasis on its problems and its complexities. If this industry is to continue as a competitive service for consumers, broad understanding of the realities of consumer credit will have to be fostered by the organizations participating in the market.

The Sub-Council therefore recommends:

"An informed public is essential to rational, constructive progress in any area. Consumer credit is no exception."

RECOMMENDATION 1

CREDIT GRANTORS SHOULD SUPPORT CONTINUING EDUCATIONAL PROGRAMS AT NATIONAL AND LOCAL LEVELS ON THE NATURE OF THE CONSUMER CREDIT SYSTEM.

An informed public is essential to rational, constructive progress in any area. Consumer credit is no exception. Without education on this subject, misinformation on rates, costs, remedies, and other credit issues will persist and can only harm the consumer in the long run. One of the more intractable myths in this regard is discussed in the following chapter.

III. Credit Costs and Rates

In most cases when credit is extended to governments, business establishments, or individuals, the rate of finance charge must be adequate enough to compensate the credit grantor for the following:

- 1. The cost of obtaining funds,
- 2. Administrative costs, including credit investigation, current credit information on customers, billing, collection, accounting, and overhead,
- 3. The risk of slow payment on credit extensions and the costs of bad debts never repaid,
- 4. The gradual decline in the value of money due to inflation, and
- 5. Profits to attract additional funds and motivate individuals to enter or remain in the credit business.

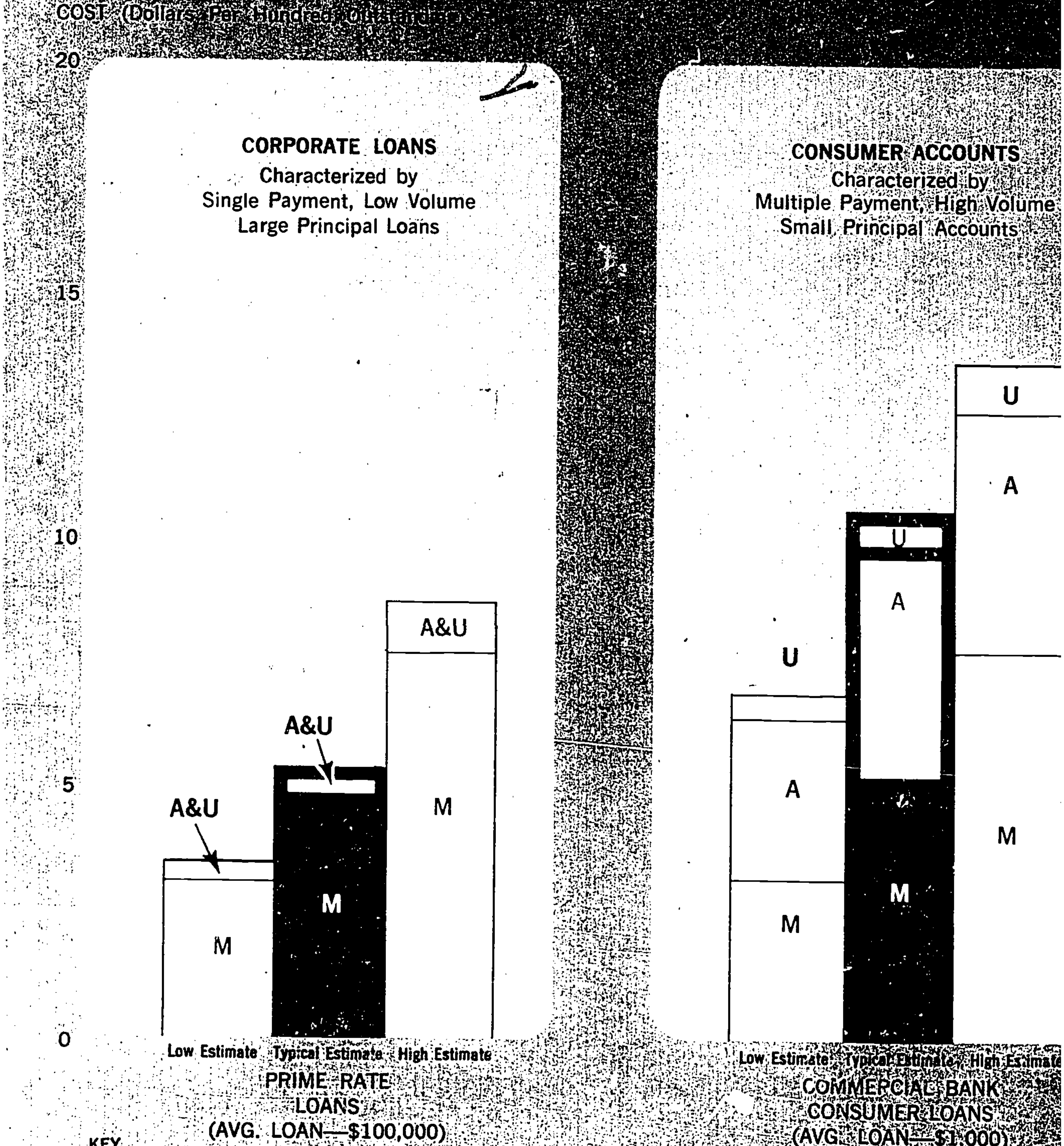
The actual level of cost associated with each of these factors can vary widely, depending on the type of credit transaction involved, as shown in Figure 2. The chart shows high, low, and typical cost estimates for corporate and consumer credit extensions. The estimates cover the fluctuations over the past decade in costs of money to credit granting institutions, and they also depict the cost ranges for administration and uncollectable accounts which have been experienced across the variety of credit granting businesses in each category.

At any given time, the lowest rate of interest available is the "prime rate" offered by leading commercial banks to selected major corporations. The rate is set by competition and it may vary somewhat between banks.

In fact, no one actually receives credit at the prime rate, since leading banks require compensating balances on deposit ranging from 10% to 20% of the loan. These are non interest-bearing accounts and they result in an additional cost of

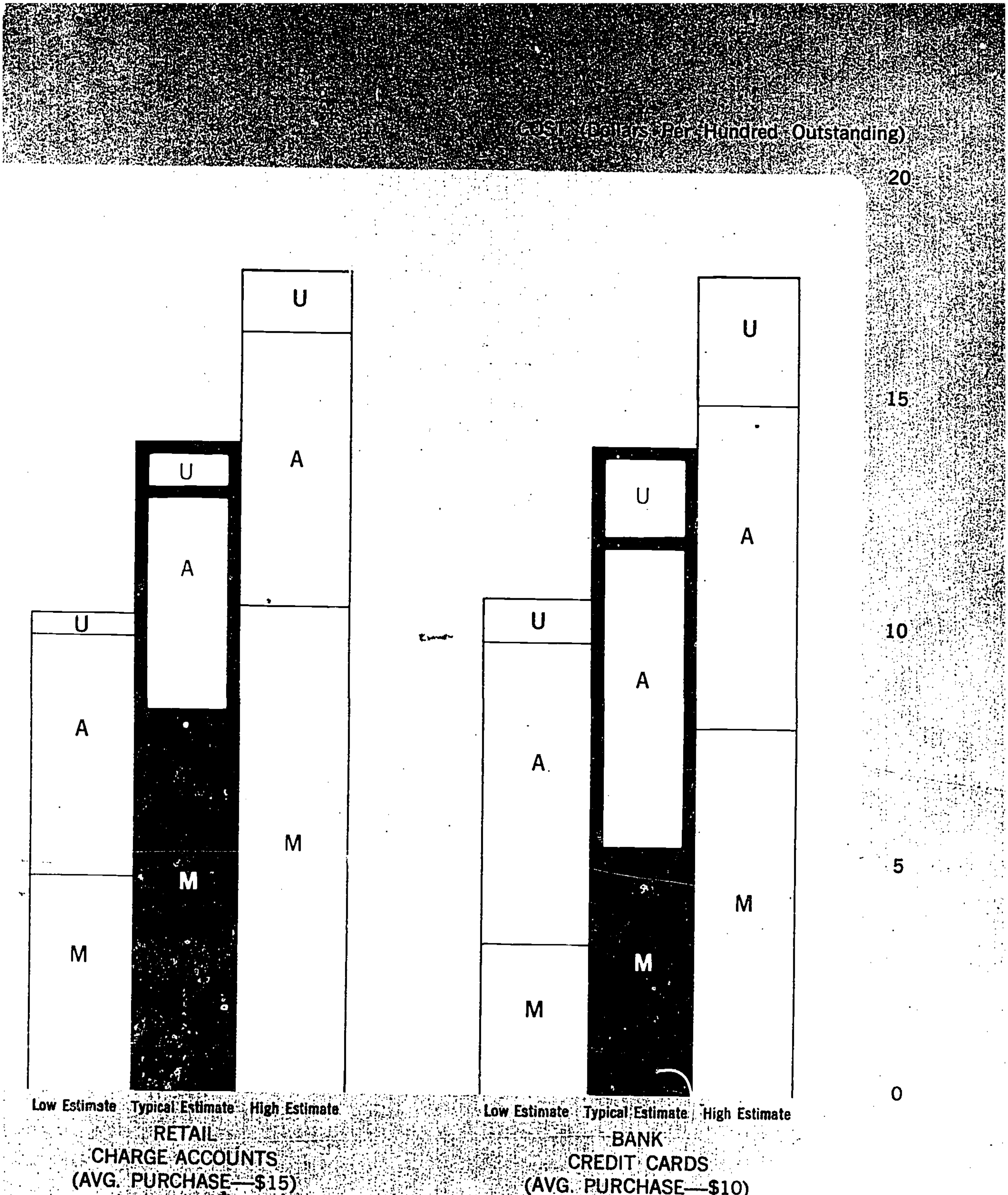
(Figure 2)

An Estimate of Comparative Credit Gran



KEY

M	**Cost of Money**—Cost to the credit grantor, including the cost of inflation.
A	**Administrative Cost**—Expense of credit investigation, records maintenance, billing, accounting, collection, credit overhead, and in cases of charge accounts, expense of maintaining accounts paid within 30 days.
U	**Uncollectable Accounts**—Extraordinary expense of billing, accounting, collection, fraud and other losses.


Cost (Dollars Per Hundred Outstanding)
20
15
10
5
0
U
A
M
Low Estimate
Typical Estimate
High Estimate
RETAIL
CHARGE ACCOUNTS
(AVG. PURCHASE—$15)
BANK
CREDIT CARDS
(AVG. PURCHASE—$10)

approximately .5% to 2% in real interest rates to the corporate borrower.

Fluctuations in the prime rate at the largest banks receive wide publicity and consumers are therefore more often aware of the level of this interest rate—in an approximate way—than other variables in the credit structure. The prime rate thus becomes a benchmark for many consumers and consumer advocates who feel that they too should be able to obtain credit at, or slightly above, this figure. This leads easily to the further conclusion that rates well above this figure are unwarranted.

That is the fiction; Figure 2 is closer to reality. As shown, the major cost component involved in prime rate loans is the cost of money to the bank. Bad debts and administrative expenses are low in relation to dollars outstanding. In contrast, all consumer credit categories are characterized by much higher administrative, billing, and collection costs, and they also include substantial write-offs due to accounts which are never collected. Most credit card systems bear the additional expense of administration of those accounts which pay in full each month, thereby eliminating all finance charge income. This figure can run to higher than 50% of the cardholders in some credit card operations.

"The prime rate thus becomes a benchmark for many consumers and consumer advocates . . ."

The typical revolving credit card account charges 1.5% per month on the unpaid balance, theroetically returning 18% per year. In fact, however, accounts are usually not charged over the initial period from the credit purchase to the application of finance charges. This averages about 25 days without charge for each purchase, a factor which drops the real rate of finance charge to about 14%, which must be evaluated in terms of the administrative costs and risks involved. Also, some credit plans do not assess finance charges for the first billing cycle, extending this no charge period for as much as two months.

Regulations at the local or national level which ignore the realities of credit cost factors can result in serious damage to the consumer credit system. The consumer's message is clear—he wants the convenience and service associated with the latest developments in consumer credit practices. Since this credit is offered in a highly competitive market, the customer's choice should not be unnecessarily restricted by artificial regulatory restraints.

Most of these powers lie with government, but there is one principle which can and should be observed by credit grantors, particularly those which offer credit as an adjunct to the sale of goods and services. In short, the user of credit in these establishments should pay for the credit service he receives, in accord with the following recommendation:

RECOMMENDATION 2

WHENEVER POSSIBLE, CREDIT GRANTING SYSTEMS SHOULD AVOID PASSING COSTS ON TO NON-CREDIT USERS.

This concept should be a basic operating policy for all credit grantors. The extension of credit, and the administration of the systems related to it, should stand as an individual, independent business service and be accounted for separately. Its costs should be covered by finance charges, and the system's expenses should not be an unreasonable burden on other customers. When credit operations are funded via unreasonably higher prices in other areas, the consumers who choose not to use credit must absorb these costs, a result which is unfair and unwarranted.

". . . consumers who meet their credit obligations should not be subsidizing, directly or indirectly, those consumers who do not."

There is a corollary to this principle which also should be followed, namely, those consumers who add cost to the administration of consumer credit systems through default or delinquency in payment should cover the expenses involved. In other words, consumers who meet their credit obligations should not be subsidizing, directly or indirectly, those consumers who do not. Thus, late charges and collection fees should, to the extent possible and allowed by law, cover the administrative and other costs associated with these activities.

IV. Credit Criteria and Availability

The Nation's credit granting system makes credit available in sufficient amounts to meet the needs of all but some low-income consumers. Virtually all creditors use judgments about ability and willingness to pay as the major criteria in deciding whether to grant credit, and at what level. As a result, those with the lowest incomes, especially if they do not have an established good payment record, often find that they do not qualify for consumer credit.

"Thus, a consistent source of income at a reasonable level is the primary prerequisite to the receipt of consumer credit."

This conclusion is confirmed by a recent finding of the National Commission on Consumer Finance that banks and finance companies believe unemployment to be the primary cause of debtors' failure to meet their obligations. Thus, a consistent source of income at a reasonable level is the primary prerequisite to the receipt of consumer credit. Closely associated with this factor is the customer's willingness to repay, as indicated by past payment records. These are the appropriate criteria to use in the extension of consumer credit, as stated in the following recommendation:

RECOMMENDATION 3

CREDIT GRANTORS SHOULD CONTINUE TO USE ABILITY AND WILLINGNESS TO REPAY AS THE PRINCIPAL DETERMINING FACTORS IN DECISIONS RELATING TO THE EXTENSION OF CREDIT.

Discrimination among consumers on other grounds should be carefully limited by hard facts, and of course, the use of race, creed, or sex is clearly unwarranted and illegal.

Credit Criteria for Women

"Discrimination against women in credit granting systems can be subtle, but serious . . ."

Discrimination against women in credit granting systems can be subtle, but serious, as shown in recent hearings on the subject by the National Commission on Consumer Finance. There is only one principle here which is fair and reasonable and it is stated in the following recommendation:

RECOMMENDATION 4

CONSUMER CREDIT GRANTING CRITERIA SHOULD BE THE SAME FOR MEN AND WOMEN. WHEN THEY MEET THESE CRITERIA, MARRIED WOMEN WHO SO REQUEST SHOULD BE GRANTED CREDIT IN THEIR OWN NAME.

All credit granting companies should review their procedures to be sure that these guidelines are followed.

Credit and the Low-Income Consumer

The problems of credit availability can be significant for lower income individuals, since credit often provides the only means for obtaining consumer durables and other goods which can be paid for throughout, rather than prior to, their useful life. These and other benefits which flow from consumer credit have stirred some individuals and organizations to seek wider availability of credit for low-income consumers almost without regard to reasonable predictions of ability to repay. Where credit grantors have yielded to this pressure on an experimental basis, the results have been generally unsuccessful for both parties.

The Sub-Council can identify no promising alternative under present credit regulations to the continued use of standard ability and willingness to repay criteria by credit grantors which would provide reasonable additional extensions of credit to lower income consumers. In a competitive credit marketplace, where ceilings are placed on interest rates, the net result of providing credit to higher risk individuals would be losses to the credit grantor, or subsidization by other consumers through higher prices for money or for goods. Both of these alternatives are unfair and unworkable.

Within this context, however, credit grantors should continually seek ways to make credit available to lower income consumers. Specifically, customers seeking reasonable credit arrangements should not be rated and rejected, once and for all, as stated in the following recommendation:

". . . customers seeking reasonable credit arrangements should not be rated and rejected, once and for all."

RECOMMENDATION 5

CREDIT GRANTORS SHOULD UPDATE CUSTOMER CREDIT RATINGS ON A REGULAR BASIS, OR UPON REQUEST.

Reporting of favorable changes which affect rating criteria should be encouraged, and rating review should be available at the customer's request, both with respect to initial eligibility and subsequent credit limits. In this process, unfavorable information should be purged from the file if it is no longer applicable.

One additional principle should be considered as a basic guideline:

RECOMMENDATION 6

CREDIT RATING SYSTEMS SHOULD NOT UNFAIRLY DISCRIMINATE BETWEEN TYPES OF INCOME.

The American economy is definitely moving in the direction of income supplements and income maintenance, through growing use of welfare, unemployment, hospitalization, pension and other income subsidies. These payments have become consistent and secure for a growing number of citizens and they should be treated objectively and fairly for credit granting purposes. This includes alimony income which should also be given full and fair consideration in determining credit eligibility and limits.

In many ways, credit is more important within these income categories than others, since that is often the only route to purchase major, lasting product investments which can add substantially to long-term standard of living.

Consumer Credit Counseling

"Professional credit counseling . . . is particularly important to those with lower incomes, or those seeking to use consumer credit for the first time."

In any attempt to identify corporate activities which might lead to wider availability of consumer credit, the role of consumer credit counseling cannot be ignored. Professional credit counseling can be helpful to many consumers, but it is particularly important to those with lower incomes, or those seeking to use consumer credit for the first time. Careful advice and guidance can often be the dominant factor in the establishment of a good versus a poor credit use record and rating. The Sub-Council therefore recommends:

RECOMMENDATION 7

CREDIT GRANTORS SHOULD SUPPORT THE ESTABLISHMENT OF PROFESSIONAL CREDIT COUNSELING SERVICES FOR CONSUMERS.

Most metropolitan areas have independent consumer credit counseling programs which provide debt counseling, and in some cases debt adjustment, services. They are operated on a non-profit basis and have proved their worth in almost every instance. They deserve continued support from the business community.

In addition, credit grantors have a continuing responsibility throughout the life of a consumer credit transaction to provide credit counseling assistance, directly or by referral, to customers. Some of the principles which apply here are discussed later in the report in the Code of Billing and Collection Practices.

The Uniform Consumer Credit Code (UCCC)

In the future, some changes in the credit system would be helpful in broadening the availability of credit. The Uniform Consumer Credit Code, which simplifies credit regulation and abolishes most prevailing rate restrictions in favor of a single set of maximum ceiling rates, would provide the framework for offering of credit to higher risk customers on at least a limited basis. In the Sub-Council's view, this Code is a balanced, constructive approach to credit regulation and we therefore recommend:

"[The UCCC] . . . would provide the framework for offering of credit to higher risk customers on at least a limited basis."

RECOMMENDATION 8

THE STATES SHOULD USE THE UNIFORM CONSUMER CREDIT CODE AS THE BASIS FOR MODERNIZING THEIR CONSUMER CREDIT STATUTES.

The UCCC is a complex document which is the product of many years of effort by the Nation's legal community. It can only be given the most cursory review in a report of this nature, but in brief it provides for credit granting entirely within a free market. Compared to present state laws, it reduces the amount of detailed government regulation. The Code should generally result in an increase in the supply of available credit to all income levels, and in some cases it should also result in a reduction in rates. The UCCC has been enacted in seven states—virtually intact in Utah, and in modified form in Colorado, Oklahoma, Indiana, Idaho, Wyoming, and Louisiana. Additional enactment could provide a desirable national uniformity in credit practices, while continuing state control of this marketplace.

In addition to broader use of the UCCC, implementation of recommendations made by the recent Commission on Financial Structure and Regulation, such as permitting savings banks and savings and loan associations to make consumer loans, might widen the availability of consumer credit. Also, the findings and recommendations of the National Commission on Consumer Finance, expected in January 1973, may point the way to new avenues for low-income credit availability.

Consumer Credit Information

Over-extension of consumer credit usually results when the credit grantor errs in his judgement of, or ignores, the applicant's ability to pay, or when the applicant himself over-estimates his repayment ability.

From the credit grantor's point of view, these decisions often depend on reliable credit information. Some legal limits have been placed on the use of credit information, and proposals have been offered which would add further restrictions. Consumer rights should be protected in this area, but it should be noted that a continuing trend in this direction can be harmful to the consuming public if it results in greater credit over-extension, or in the curtailment of credit availability.

"... the Nation should be moving toward, not away from, an improved credit information system, so that credit granting decisions can be made fairly and correctly on the basis of hard fact."

Thus, the Nation should be moving toward, not away from, an improved credit information system, so that credit granting decisions can be made fairly and correctly on the basis of hard fact. To this end, the Sub-Council recommends:

RECOMMENDATION 9

GOVERNMENT AGENCIES AT ALL LEVELS SHOULD AVOID ACTIONS WHICH UNNECESSARILY ERODE CONSUMER CREDIT INFORMATION SYSTEMS.

Operation of a rational and efficient consumer credit system would be impossible without this information. Over-extension, and even bankruptcy, would rise as the accuracy of this data decreases, so all reasonable precautions should be taken to insure its quality.

In this context, provisions should be made for consumers to easily identify and rectify any errors in their personal file. In addition, the confidentiality of the data should be carefully preserved to respect the consumer's right of privacy against unauthorized use of credit information.

". . . the confidentiality of the data should be carefully preserved to respect the consumer's right of privacy . . ."

Consumer Credit Education

Educational materials and courses can be a constructive and meaningful route for many consumers toward understanding and responsible use of consumer credit. Included within the activities which credit grantors can undertake in this area are:

- offering written material to customers on consumer credit, particularly information which is pertinent to the type of transaction involved.
- encouragement and support for formal consumer credit curricula in educational systems at all levels.
- providing executives knowledgeable about consumer credit to educational institutions as consultants and lecturers.
- sponsorship of media programming which includes consumer credit educational material.
- use of advertising to inform and educate consumers on consumer credit.

These efforts can provide the consumer with continuous assistance on spending and budgeting his income. In recognition of the opportunities which exist in this area, the Sub-Council recommends:

RECOMMENDATION 10

CREDIT GRANTORS SHOULD DEVELOP, SUPPORT AND ENCOURAGE CONSUMER EDUCATIONAL PROGRAMS ON PERSONAL MONEY MANAGEMENT.

Excellent examples of programs of this type, in a wide variety of forms, now exist in the consumer credit industry. They should be continued and expanded wherever possible to provide a broader understanding of the opportunities and limitations of consumer credit for individuals.

Creditor-Merchant Relationships

"Most credit granting institutions realize that the day is past when support by way of consumer credit can be given to any merchant regardless of his marketing practices."

Most credit granting institutions realize that the day is past when support by way of consumer credit can be given to any merchant regardless of his marketing practices. This conclusion is supported by Federal Trade Commission studies which show that special purpose merchants who use questionable pricing and other sales procedures generally tend to self-finance their consumer paper rather than follow the normal procedure of transferring the burden to financial institutions.

The ability and responsibility of credit granting organizations to actively police the marketplace in this regard is limited, but, at a minimum, care is in order to avoid endowing disreputable firms with credibility and assistance. To this end, the Sub-Council recommends:

RECOMMENDATION 11

FINANCIAL INSTITUTIONS SHOULD AVOID FINANCING THE PURCHASE OF PRODUCTS OR SERVICES SOLD BY UNETHICAL MERCHANTS.

In carrying out this responsibility for consumers, third party credit grantors should work closely with local consumer protection organizations, Better Business Bureaus, and other groups in a position to identify unscrupulous business practices unworthy of support from reputable firms. Those firms responsible for inordinate numbers of consumer complaints, or which refuse to take responsibility for legitimate consumer problems with their merchandise, should be refused further opportunity to sell their paper to the credit grantor.

V. Billing and Collection Practices

Consumer credit is extended with the expectation that it will be repaid, and, with rare exceptions, consumers charge purchases or borrow money fully intending to meet their repayment obligations. As a result, the overwhelming majority of consumer debts are repaid without further difficulty. Although the percentage of credit transactions involving disputes is relatively small, from a national perspective, delinquent debts amount to approximately $2.4 billion on nearly 4.4 million late-paying or non-paying accounts.

"... from a national perspective, delinquent debts amount to approximately $2.4 billion on nearly 4.4 million late-paying or non-paying accounts."

The Collection Process

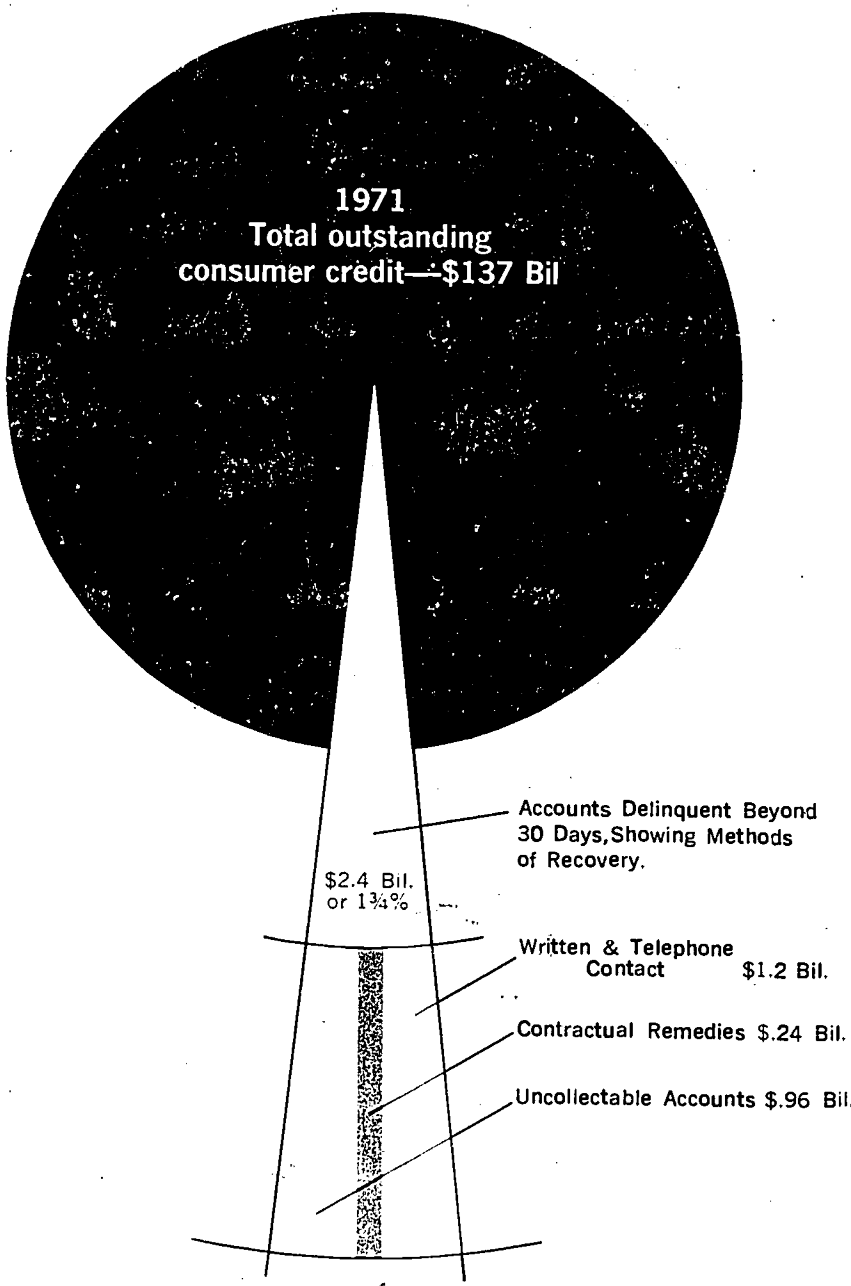
The first step in the collection process is the customer's bill. In the case of closed-end credits, such as level payment loans, the bill may take the form of a coupon book specifying the amounts due and when. Open-end credits such as department store charge accounts, charge cards, and check credit mechanisms bring a monthly bill indicating, among other things, the customer's new balance, the minimum payment due, the finance charge and the date, if any, by which payment must be received to avoid a finance charge.

For unpaid bills, the first reminder may be sent 5 to 30 days after the bill is due for payment. If delinquency continues, additional notices follow, urging prompt payment and generally graduating in the seriousness with which the continuing delinquency is treated. All but a handful of customers pay long before the advanced stage of written communications is reached.

When notices and letters fail to bring results, personal contact, normally by telephone, follows. Most creditors do not initiate telephone collection until the account is at least a month or more overdue. This provides an opportunity to learn the cause of the delinquency, and to encourage the debtor to make partial payment or take other steps to cure the default. Collectors typically also explain the remedies and penalties that may be invoked if the debtor fails to take any action.

Consumer Credit Delinquency

(Figure 3)



Source: Federal Reserve Board and American Bankers Associaion Data.

Relatively few consumers are ever contacted by telephone collectors. But approximately 2.2 million accounts totaling $1.2 billion— roughly one-half of all delinquent accounts— are restored to current status by this procedure.

For the remaining delinquent debtors who fail to respond or who break promises to resume payment, more serious actions are required. Depending on the circumstances, these actions may be initiated 45 to 90 days or more after payment is initially due. The creditor may resort to remedies allowed by law under the original contract such as repossession of merchandise, attachment of wages, and off-sets against deposit accounts. Use of contractual remedies, or informing delinquent customers of their availability, is estimated to account for recovery of $240 million on 350,000 delinquent accounts annually.

If contractual remedies prove to be insufficient, the creditor usually initiates court action. In this process, only a small number of customers actually appear in court, so these actions usually result in default judgments in the creditors' favor.

The total amount recovered as a result of legal processes is not currently known, but an estimated $960 million in consumer debt is written off annually as uncollectable, as shown in Figure 3. Together with expenses incurred in successful recovery of delinquent debts, these bad debts are a significant element in determining the finance charges which creditors must impose.

Debtor Grievances

As previously pointed out, the early stages of the collection process can generate friction. Billing errors frequently cause disputes. Delays in correcting mistakes add to consumer irritation. The time span allowed between mailing of a bill and the due date for the next payment can also become an issue.

Later stages of the collection process cause the most vigorous, though not the most numerous, complaints. Common accusations at the personal contact stage include invasion of privacy through telephone calls made at unreasonable hours, use of abusive and threatening language by telephone collectors, and harassment by creditors who contact employers about the delinquency.

Resort to remedies available under the credit contract, such as repossession or wage assignment, are frequently attacked as denying the debtor his day in court. In addition, since repossession is often followed by re-sale for an amount less than the sum outstanding on the debt, deficiency judgments to cover the remainder often cause further complaints by the debtor. These complaints result directly from the fact that the original retail price is not an appropriate measure of value of the item when sold in used condition. The retail price includes commission, overhead, and, in effect, initial depreciation, which the creditor must either collect or absorb when selling the repossessed merchandise at a discount.

An additional underlying complaint, common to many stages of the collection process, is the contention that disclosure of the terms of the debt is often inadequate and that the obligations and rights of the borrower are rarely explained to him in plain language.

The "Holder-in-Due-Course" doctrine has also been attacked as unfair to consumers in today's marketplace. This legal priniciple largely absolves third party credit grantors from responsibility for goods and services sold by another firm to consumers receiving the credit. All bank credit card transactions, for example, fall within this purview, so that the consumer is obligated to pay on his account even though the items purchased may have been defective. His recourse is against the retailer, not the bank holding his credit card account.

The Sub-Council has not carried out a comprehensive survey on the use of holder-in-due-course by businesses, but it appears that many, if not most, credit granting institutions which operate at a nationwide level rarely use this legal doctrine in a collection context. Recent findings published by the National Commission on Consumer Finance support this conclusion.

Businesses of any size which use holder-in-due-course rights should be certain that they are not employed against consumers in an arbitrary or heavy-handed manner. Consumers always have the right to a fair hearing of their complaints, even when the holder-in-due-course principle applies. Thus, credit granting institutions should assist in every feasible way to achieve an equitable resolution of the consumer's problem. This practice is specifically stated in point 13 of the following code of billing and collection practices.

In addition, as stated previously in Recommendation 11, financing agencies have the responsibility to refrain from supporting merchants which practice questionable or unconscionable methods in dealing with consumers.

"Consumers always have the right to a fair hearing of their complaints, even when the holder-in-due-course principle applies."

Code of Billing and Collection Practices

The Sub-Council has concluded that many legitimate complaints can be eliminated by ethical lenders through adherence to the following code of billing and collection standards. These standards assume that most debt problems arise through circumstances beyond the control of the borrower, that ethical credit grantors should be willing to work with persons who desire to pay, and that collection practices should not offend the dignity of the borrower nor trespass on his rights:

- 1. *Creditors should fully explain to their customers the terms of any loan or credit arrangement.* This should include the repayment obligations which the customer is undertaking. The explanation should be clearly and concisely stated in understandable terminology. It should be provided in writing and, if possible, orally— with the advice that the customer also read the contract before signing. Disclosure should be made also to any co-makers or co-signers of the contract.

2. *Creditors who mail bills to customers should do so as soon as possible after billing cycle ends.* The date by which full payment must be received before a finance charge is levied must, by law, be clearly indicated. Bills should be mailed at least two weeks before payment is required to avoid a finance charge, preferably earlier. In the event that equipment failure or administrative problems delay the mailing, a notice extending the grace period should accompany the bill.
3. *Calls or correspondence from a customer claiming an error in billing should be acknowledged promptly.* In no case should this exceed 30 days after the complaint is received. An investigation should be made, and if the complaint is valid, the customer's account should be corrected as soon as possible. If an investigation reveals that the billing is correct, the customer should be immediately notified of the fact, preferably by personal letter with documentation supplied.
4. *Consumer credit collection practices should be based on the presumption that every debtor intends to repay, or would repay if able.* Until events establish that the customer is deliberately evading payment, all communications, whether in writing or by telephone, should be based on this presumption. Preliminary late notices should merely remind the customer that payment is overdue and should recognize the possibility that payment may cross in the mail. Subsequent notices should continue to be polite, requesting the customer to call or write if there are any problems about payment. The name and telephone number of a person the customer can contact should be included if the credit grantor's manpower resources permit. If not, a contact unit and telephone number should be specified.
5. *Late charges should be assessed only to the extent necessary to recover overall expenses caused by the*

delinquency. Partial or full forgiveness of such charges should be considered where warranted.

6. *Customer complaints concerning collection practices should be investigated immediately.* Until the facts have been determined, creditors should assume that the customer's complaints are legitimate. These complaints should be treated as an opportunity for managers to check on their department's performance and to make any necessary correction.

7. *Collectors should be instructed to attempt to initially determine the cause of the delinquency and to indicate willingness to arrange a mutually satisfactory repayment schedul when appropriate.* Collectors should understand that they are dealing with individuals about highly personal matters and that most delinquencies arise through oversight or circumstances beyond the debtor's control.

8. *Customers who show a sincere desire to repay their debt should be offered, if necessary, extended repayment schedules, refinancing arrangements, or similar methods that would help re-establish their solvency.* Contractual remedies or litigation should be undertaken only as a last resort. Where circumstances indicate that such remedies will be futile because the customer will not have the assets or income to satisfy the debt, legal remedies should not be pursued blindly or vindictively.

9. *If the customer does not respond to an offer to help make alternative arrangements, the collector should explain the seriousness of continuing delinquency and advise the customer of the courses of action open under the contract and under the law.* However, personal abuse, harassment, threats and other unconscionable tactics should be forbidden.

- 10. *While collectors have an obligation to disclose honestly to debtors and endorsers the remedies that may be invoked against them, legal action should not be cited unless it can and will be used.*

- 11. *Telephone calls should be placed between the hours of 8 A.M., and 8 P.M., unless other times are more convenient for the customer.* If a collector finds it necessary to call a customer at his place of work and does not locate him, he should merely identify himself and leave a return number, indicating the urgency of a response.

- 12. *Outside collection agencies, attorneys, process servers, and other agents employed to collect delinquent accounts should be furnished with written instructions on how customers are to be approached, which practices are sanctioned, and which are not.* Creditors should monitor the activities of collectors on their own staffs, as well as their collection agencies.

- 13. *Credit grantors should be particularly careful in handling delinquencies due to a customer's dissatisfaction with the goods or services financed.* Complaints about the quality of goods or services should be promptly investigated and resolved or explained. The creditor should also notify the customer that an inquiry has been initiated. Creditors should ask the debtor to pay the portion of the debt not in dispute but should not press for payment of the disputed portion until the facts have been determined and the customer notified of the result.

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