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"Bankers, Bureaucrats and the Public Interest"
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Members of the Consumer Bankers Association are obviously a powerful force in our society. Banks are needed to play an active, initiating role in retooling for a safe, secure energy future, in revitalizing our productive growth and in rebuilding our cities. Banks hold the life savings of millions of Americans.

Bankers know that improving service to the public is in their own self-interest. An obvious example is the trend toward simple English in loan agreements. It is a service to borrowers that attracts customers. It's good business. But competition cannot adequately ensure the public interest in all aspects of banking.

As Chairman of the Consumer Affairs Subcommittee of the Banking Committee, I must look at banking practices from the consumers' viewpoint. There is clear justification for federal initiatives in various areas which I will discuss this morning. I will begin with two major concerns -- privacy and the Rule of 78's. I believe that new federal legislation is needed in both of these areas. Then I will discuss other matters important to bankers and the public: Regulation Q, Fed membership, and Truth in Lending. Then I will take your questions.

The Rule of 78's

One area where I believe the Federal government must intervene in the public interest is banks' use of the Rule of 78's. By applying this Rule to longer term loans that subsequently are prepaid, consolidated or rewritten, banks profit excessively from fine print that consumers don't understand.

I commend lenders who have chosen voluntarily to curtail or end their use of this unfair practice. Unfortunately, the vast majority of consumer loans remain subject to the Rule of 78's.

I understand that the Rule's initial use was on small loans of one year. But in recent years as precomputed consumer loans have grown dramatically in amount, length of term and interest rate, the Rule has provided many borrowers with an unexpected and very expensive education in lending practices.

Let me cite a few recent examples.

An Oceano, California family borrowed $16,000 in 1975 at an A.P.R. of 12.34% over 15 years. After 16 months they prepaid their obligation to one of the nation's largest banking systems. This family was puzzled and justifiably upset by the fact that 16 monthly payments had failed to reduce the principle.

Their bank has employed the Rule of 78's. In recasting the loan, we find that this family was required to pay $1,091 more than if the bank had rebated the unearned interest in accord with the actuarial method. As you can certain appreciate, the Rule increased the bank's yield substantially in this case.

Another example of this practice involves a Richmond, Virginia family that borrowed $15,437 in 1974 under a second mortgage with their local bank. The loan was for 10 years at an A.P.R. of 11.72%. After 24 months, the family prepaid the loan. This family was astonished to learn that their principal has not been reduced after two years of payments.

Because the bank used the Rule of 78's rather than the actuarial method, this family paid a penalty of $463.

Both families had no warning of the economic penalty inherent in using the Rule of 78's for longer term transactions. Tens of thousands of borrowers are similarly victimized when they prepay, consolidate or rewrite their precomputed loans. The practice usually goes undetected because the borrower is unaware that the actuarial method would afford a more equitable rebate.

I think of it as "Catch 78." The Rule of 78's is an archaic, unfair lending practice that must be restricted or eliminated altogether in today's consumer lending market. It is a deceptive practice that demands federal regulation.

Within several weeks, I will submit legislation to eliminate the Rule of 78's wherever the term of a precomputed consumer transaction exceeds 36 months. The elimination of this practice for loans over 36 months would save U.S. borrowers upwards of $50 million annually.

Privacy Legislation

Privacy is another area in which we must do more to protect the public interest. We all know that technological advances in communicating and storing information during the past few decades have added to our nation's economic well being. Yet we must also understand that these advances are a potential threat to the right of individuals to privacy. When we apply for a loan or credit, details of virtually every aspect of our lives become computerized. But we get little protection as to how this information and misinformation may be used.

The Privacy Protection Commission concluded in 1977 that the legitimate information needs of business and government must be balanced against increasing threats to personal privacy. Senator William Proxmire has just introduced 2 bills that I believe represent a major commitment to act on many of the Commission's recommendations. These are the Fair Financial Information Practices Act and the Privacy of Electronic Fund Transfers Act.

I'm not yet a cosponsor of either bill. I expect to hold hearings on both of them beginning later this year. But I support their approach generally. We must move beyond the current patchwork to establish a national privacy policy.

The Fair Financial Practices Act strengthens privacy safeguards for personal records in banking, insurance, credit reporting and consumer credit. The Act requires banks, savings and loan associations

and credit unions to tell customers about their record-keeping, and to follow their procedures as described. It also requires credit grantors to inform individuals about their practices for collecting and disclosing information, and to follow their described policies. In addition, it provides that a credit grantor inform a person why any adverse decision was made, and disclose the facts that supported the decision. The Act is intended to create a clear, legally enforceable "expectation of confidentiality" regarding the personal records of depositors and credit seekers.

The Privacy of Electronic Fund Transfers Act safeguards the communication of an electronic fund transfer (EFT) much as phone calls and letters are protected now. It permits disclosure of information by an EFT service provider only to participants in the transfer or to government agents with a court order. I am concerned with the possibility of "real time surveillance" by the government under the bill. I will pursue this in our hearings.

The 95th Congress addressed the issue of government access to bank records by passing the Right of Financial Privacy Act. More must be done. The Administration is expected to propose more legislation this year on government access to personal records held by banks, insurance companies, and other businesses. The Subcommittee on Consumer Affairs will work to develop balanced, fair legislation.

We will deliberate on privacy legislation with an awareness of the words of Louis Brandeis, one of the Supreme Court's most distinguished justices and also a long-time Massachusetts resident. Brandeis wrote that "the right to be let alone" is "the right most valued by civilized men."

Regulation Q

The average citizen doesn't want his or her privacy limited by government. In these inflationary times, citizens don't want Washington to limit interest rates on savings accounts either. Market interest rates for Treasury bills and other unregulated financial instruments are very high, but they are out of many Americans' reach. I believe it is time to start phasing out Regulation Q.

I have supported Senator Proxmire's bill to phase out Regulation Q over 10 years. Under it, interest ceilings on savings accounts would be phased up by half a percent each year until they reach market rates. An increase can be postponed if it would have an adverse impact on the economy or on the viability of financial institutions.

Thrift institutions will face some problems. Without Regulation Q, they will be able to pay market interest rates but will lose the differential that helps them attract funds. They also will be restricted in the kinds of deposits and investment they can pursue. Therefore, I am sponsoring an amendment to allow savings banks to receive any type of deposits (such as commercial) and to use up to

20% of their assets for investments. 65% of the investment would have to be within the state or within 50 miles across state lines. The amendment would phase in the investment power while Regulation Q is is "deregulated.", Senator Proxmire's bill is scheduled for floor action this week.

Federal Reserve Membership

Another vital issue involving federal regulation of banking is membership in the Federal Reserve. Chairman Paul Volcker has made it clear that he wants action this year on a Federal Reserve membership bill. The House has passed a compromise version, but the Senate Banking Committee has not yet scheduled its mark-up.

Many issues are involved, including:

- voluntary vs. mandatory reserves
- reserve requirement structure
- cost to the Treasury
- pricing of Fed services
- number of banks subject to reserves
- interest-bearing supplement reserve requirements.

How can the Federal Reserve best serve and protect the public? To date, the Fed has not made an overwhelming case that mandatory reserves are needed. Some bankers in my state who don't hold reserves at the Fed are concerned about the effect a large reserve increase would have on their earnings and their ability to make local investments. I haven't yet committed myself on the specific issues raised by this legislation, and I welcome your comments as we take it up.

Oversight and Regulation

Next Wednesday and Thursday, October 31 and November 1, the Consumer Affairs Subcommittee will hold oversight hearings on Truth-In-Lending enforcement by federal banking regulatory agencies. An obvious focus of our hearings will be the recent collapse of the so-called "uniform enforcement guidelines" implemented by these agencies last spring and suspended in August. I believe it will be helpful to establish a public record as to the reasons why the agencies have proposed altering these guidelines substantially.

I am also very interested in the uniformity of enforcement of Truth-In-Lending. There can be no question that enforcement efforts have varied significantly from agency to agency. There also seems to have been a lack of uniformity among regions in certain agencies.

Finally, let me say something about regulation in general. The rhetoric about "over-regulation" has been overdone. Finding the right degree of government regulation in banking issues is a hard task. In the long run, your banks must serve the public well in order to prosper individually and as an industry. Your representatives in Congress must work toward the right regulatory balance in order to survive at the polls. Let's work together to achieve balanced policies that serve the public best.

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