Time for the Fed to Make Card Disclosures Clear
Thursday, March 24, 2005

After 36 years of struggling with the Truth-in-Lending Act, the Federal Reserve Board wants comments by March 28 about a possible streamline of Regulation Z's open-ended disclosure mandates. As if to assure us that it is not up to the task, its notice is verbose, hesitant, and suggestive that disclosure overload is going to get worse.

Here's the truth: Truth-in-Lending and Reg Z are failures. The obtuse disclosures they impose make borrowers apathetic, enable creditors to be devious, and breed cynicism about bank regulators. They do little to edify consumers but much to enrich lawyers. They need radical surgery.

I know about this problem firsthand. Until the mid-70s retail credit agreements were as awful as they are today, but less so because of government disclosure mandates, which were a fraction of what they have become.

Back then the agreements were mostly the baby of big law firms. As such, they looked suspiciously like commercial lending agreements. They came packed with thousands of words of questionable terms in legal gibberish.

At my behest, Walter Wriston appointed a team in 1974 to simplify these agreements. Immediately the going was rough. Plain language scared the wits out of outside counsel and product managers. They feared a spotlight on practices that customers and the media might view as heavy-handed.

Because of our effort, they reluctantly dropped whatever couldn't pass a smell test. The exercise taught us that short, transparent agreements will influence not just the description but the substance of a product - to the mutual benefit of bank and customer.

In light of how the government has put us back to square one, I wonder if the private sector, had it been left alone, would have done a better job with transparency than the Fed. Perhaps credit competition might have been more robust.

Reg Z's suffocating disclosures haven't helped in that regard. Lenders compete mostly through words. Drown their products with lawyer-crafted mush, and competition will suffer, because useful information gets lost in the process.

The lesson here for the Fed is that competition, and thus product development, are better served with a minimalist approach to disclosure mandates. Among other things, that means the Fed should amend Reg Z to limit disclosure mandates to the most relevant protections, each of course in plain language and useful formats.

To ensure minimalism, the Fed should end the practice of providing model disclosures. Let creditors write what they must in their own words. And stop requiring that certain disclosures be conspicuous. The Schumer Box is proof that excessive highlighting encumbers the reading exercise.

That's the easy stuff. A harder challenge for the Fed is standardized Reg Z terms like "finance charge" and "annual percentage rate," which have lost their value as useful disclosures. Because of recent changes in industry pricing, they distort the true cost of revolving credit. Zero, low, and "fixed" APRs for card products come with enough conditions to make a mockery of Reg Z truthfulness. The real truth is creditors know with an almost mathematical certainty that the advertised rate will rapidly escalate in predictable time frames to ensnare millions of customers.

While misleading, the way these rates are described in advertising and cardholder agreements is totally legal, thanks to Reg Z.

To tackle phony APRs, the new rule should include late, bad-check, and over-the-limit fees in the APR calculation. The initial justification for keeping them out - they were considered inconsequential - no longer applies.

Late and similar fees are rapidly becoming the major revenue source of the card industry. With an avalanche of "change of terms" notices, sometimes several in one year and many of them unreadable, card companies have ensured that customers will have to pay these fees on a predictable, recurring basis, just like interest. They should be treated as such.

The Fed has resisted this change for decades, due to industry lobbying. It didn't want to shock cardholders because of a one-time event, like missing a payment.

But card companies have come to enjoy shock treatment - so long as it involves collecting harsh penalty fees from millions of cardholders, not just once in a while but as often as possible. It's worth tens of billions to them annually. This time, the Fed should resist the lobbying.

It should also take a tough approach on the Bizarro World cardholders have to enter to calculate finance charges and APRs. Reg Z currently offers them little help in fathoming the mazes of daily balance additions, subtractions, multiplications, and payment allocations, not to mention compounding, averaging, and who knows what else - forcing them to rely totally on faith that the creditor's computer got everything right.

But before the Fed attempts to rewrite the calculation disclosure, it should ask the card industry why issuer pricing is so complex. Is it that way because the product is intrinsically complex, or because of straitjackets imposed by the law? Why is card pricing increasingly the most complex of any consumer product? Is this fair to consumers?

Of course, these are leading questions. Not only is pricing simplicity possible, but the Fed should insist on it.

The Fed has to stop hiding from the failures of Reg Z. Every time it does, it favors lenders over borrowers.

To be fair, the Fed is in a mess because of Congress, whose muddled Truth-in-Lending Act guaranteed the sludge in Reg Z. Had Congress originally called the law the "Lender Disclosure Act" and never mentioned the word "truth," the Fed might have produced something more pragmatic and creative in the years since 1968. Instead, regulators were doomed to chase their tails for a generation on a concept that has eluded philosophers since ancient Greece.

The result is a Reg Z bloated with three decades of lawyer nit-picking and creditor disclosures that are all but useless to regular people. If the Fed can't tame this monster, sooner or later courts will try to do the job for them, probably making things worse.

By Duncan MacDonald Mr. MacDonald is the former general counsel of Citigroup Inc.'s Europe and North America card businesses.

Disclosure Overload: Lawyers Are Problem, Not the Solution
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By Duncan MacDonald

The efforts of seven regulators to introduce uniform, conspicuous plain-language standards for consumer financial disclosures are doomed to failure. The reason is simple: The lawyers are in charge.

The feds' goal is to amend a slew of regulations (Z, B, E, etc.) with input from anybody with an interest. They have asked for comments by Jan. 31.

Lawyers, of course, will dominate the process, perhaps in excess of 1,000 of them from the feds' staffs and those who will comment. And that raises a few questions:

- Is it sensible to believe that a discordant chorus of 1,000 members of the bar can advance the cause of disclosure clarity?
- Aren't lawyers authors of the mess the feds want to undo?
- Isn't the real problem disclosure overload?

Let's look at some more numbers. Thirty years ago the documentation for basic loans, cards, and auto financing could fit on one or two pages, and mortgages could close with fewer than 10 pages in most places. Today the basics cover up to 20 pages and mortgages upward of 150.

Without radical pruning, in 10 years these numbers probably will double or triple, even with plain language. Is this consumer protection?

I have been an advocate of plain language since my days in law school in the 1960s. In the mid-70s I wrote the first banking agreement in plain language and the first plain language law in the United States. My efforts, I am sorry to say, had little impact in making consumer agreements easier to read.

Plain and simple, government suffocated the plain-language movement. Its lawyers did it over several decades by imposing on banks layer upon layer of complex, obtuse, and often contradictory disclosures.

Their domination of retail bank documents is so complete that almost nothing of consequence is left for business lawyers to put into plain language.

Government has made things so bad that it is hard to imagine its latest effort can change the status quo, even minimally. It is clear from the notices the feds published in the Federal Register that they do not intend to attack the actual problem, disclosure overload.

If the feds really want to help consumers shop for financial services, they should approach the task from a totally different perspective. They should talk to experts who know about consumer shopping and reading habits. They should ask:

- What is the percentage of consumers who shop comparing fed disclosures? (My guess: a thin fraction of 1%.)
- Which kinds of disclosure best capture the attention of consumers?
- Is it simplicity that does the trick, or something else?
- Who in the private and public sectors produce the best disclosures?
- Are the documents the feds' would like consumers to compare available?
- What does disclosure glut cost consumers and banks in paperwork, attorney usage, time, dispute resolution, and the like?

These and other questions will lead the regulators to what everybody else already knows - that their top-heavy disclosure regime has failed completely. Not only does it ensure that consumers will never read bank documents, it forces excessive dependence on lawyers.

To break that dependence so that real reform can happen, the feds must take bold action. For starters, they should put non-lawyers in charge of the cleanup effort, set their sights exclusively on disclosure overload, and seek ideas from people who are more efficient with words than lawyers: journalists, teachers, composers, novelists, Madison Avenue, sign makers, even poets.

The unspeakable should happen: Lawyers should be kept out of the picture as long as possible.

In the meantime, the new team should note the following:

- ❖ *Other government agencies are good at plain language*. The labeling of food, medicine, and clothing is a good example. The ingredients of a package of hot dogs, the side effects of an aspirin, and how to clean a cashmere sweater are regularly conveyed in a square inch or two. Signs we see everywhere do the same thing.
- ❖ *Plain language is useless without a relentless commitment to brevity*. Turning 20 pages of disclosures into shorter, easier-to-read sentences that will add up to 30 pages is not what consumers need or want. Less is best.

- *Even in plain language, it is easier to hide bad information in a long document - one cluttered with government-required disclosures - than a short one*.
- *Making disclosures uniformly more conspicuous is not a solution*. It would be silly to believe that consumers will read a privacy statement or arbitration clause at the top of an agreement because it is in large, bold, or colored type or festooned with bullet points.
- *In the long run, uniformity is impossible*. No matter what the feds hope to achieve through uniformity, Congress, the states, and judges will upset the plan every time a hot new issue suits their fancy.
- *Every new disclosure requirement diminishes prior disclosures and undermines other important provisions of contracts*.
- *Requiring that many notices be conspicuous implies that the rest of a document is less important*. That can be unfair and even unconstitutional. It can also be self-defeating; an excess of such notices, which arguably exists today, neutralizes their conspicuousness.
- *There is no good reason why basic loans can't fit on one page in a reasonable type size, and mortgages in not more than four*. Don't let the lawyers bully you into thinking otherwise.
- *Disclosure overload befuddles consumers and banks every time they do business with each other*.

Plain-language disclosures are overdue by about 30 years. Unfortunately, the current cleanup effort looks phony. If regulators again let lawyers dominate the process, why bother?

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