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Two Ways to Help Consumers Understand Loans

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The long accumulation of federal and state disclosure requirements has created information overload. Many borrowers have simply stopped trying to sort out what is important and what is not.

When they receive a thick packet of consumer credit disclosures with their loan package, how do they decide what they should read? Do they know what an APR is? Do they know how a credit score will affect the price they pay for credit? Do they read the disclosures at all?

Acting Comptroller of the Currency Julie Williams recently contrasted the complexity of financial disclosures with nutrition labels. Consumers regularly study those labels. Nutrition facts are accessible and presented in a way that is simple enough to be understood by the average consumer.

It would be a great step forward if credit disclosures could become equally accessible and useful.

Simplifying and rationalizing credit disclosures would be a win for consumers and creditors. The complexity of our disclosure laws creates compliance risks for lenders, and class action litigation in this area has been on the rise for several years. It might be argued that the principal beneficiaries of the current disclosure regime are the class action lawyers who extract settlements from lenders for technical violations.

Two initiatives would benefit consumers and creditors:

Provide financial information in manageable increments. Neither Congress nor state legislatures have attempted to coordinate or prioritize the presentation of credit disclosures. The Federal Reserve



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should conduct a study on exactly what information is helpful to borrowers.

Any such study should include use of focus groups and behavioral experts to test disclosure formats on consumers. With this information in hand, the content, format, and timing of disclosures could be organized to ensure that consumers are getting what they want: appropriate, manageable information that makes sense.

Reorganizing disclosures would not require that creditors dumb down the information. If it were presented on a continuum of more to less important, consumers who did not want to wade through the details could avoid doing so, while others could delve into the fine print. Though the change might involve some policy choices about what is important, much of the format and content could be dictated by what consumers find useful.

An even better way to provide this information would be electronically. Terms could be explained when the consumer let the mouse hover over a hyperlinked term or clicked to a definition.

Electronic calculators embedded in financial Web sites could illustrate loan terms better than the printed boilerplate now used. These tools would allow consumers to plug in their own situations and to see how the terms on the loans they are considering would really affect them.

Make financial training available to every high school student. Using the consumer study, a training tool could be developed that would be the modern financial equivalent of "McGuffey's Readers," the standard texts used to teach reading in 19th-century classrooms.

The new "Financial Reader" should be available in every high school's curriculum. Learning to handle credit is as important today as learning to drive.

Any comprehensive effort to promote transformative change would have to be initiated by the Bush administration, Congress, or the Fed. The Fed would be a logical choice; it is responsible for administering many current consumer credit disclosure programs and has the talent, resources, and credibility to bring about change and recommend changes in law.

This might be a nice parting gift from Chairman Greenspan to America's consumers and the businesses that serve them. It could be an enduring legacy.

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