(Hon. Abraham J. Multer, ranking member of the Committee on Banking and Currency and sponsor of H.R. 11806, submitted the following article from the September 1967 issue of Consumer Reports magazine, published by Consumers Union, Inc., for inclusion in the record of the hearings.)

[From Consumer Reports, Mount Vernon, N.Y., September 1967]

THE BIG HOLE IN TRUTH-IN-LENDING

The bill passed by the Senate would allow comparative costs of revolving credit to remain obscure; other weaknesses in the bill are small by comparison

Senate passage of the Truth-in-Lending Bill last July represented a 92-to-0 vote of confidence in the ability of consumers to shop wisely for credit when given the essential facts. Those facts concern the true price of money, whether borrowed directly from a lending institution or indirectly through the purchase of goods and services on the installment plan.

Except in the realm of consumer credit, the price of money is everywhere expressed as an annual interest rate—the percent of principal the borrower must pay for a year's use of someone else's money. Truth-in-Lending legislation would simply give consumers the same information that has always formed the basis for nonconsumer borrowing. For the first time in the history of this buy-now-pay-later economy, consumers would be able to make accurate price comparisons in shopping for most types of credit. The one major exception—and it could easily become a gaping hole in the dike—is revolving credit.

THE RELATIVE TRUTH

The marked differential between the true annual interest rate and the actual number of dollars charged per $100 of initial installment credit has long been a source of hopeless confusion. A "price" of $6 for $100 of credit, to be repaid in 12 monthly installments, is not equivalent to an annual interest rate of 6%. It *would* be 6% if you kept the whole $100 for a full year and repaid it in one lump sum. But you usually repay it in regular installments, and thereby lose the use of a progressively larger fraction of $100 during the year.

The true annual installment interest rate is thus usually about twice the dollars-per-hundred figure. If you borrow $100 for one year and pay back $106 in equal monthly installments, the true annual rate is not 6% but 10.9%. If you borrow $100, immediately pay $6 interest, and pay off $100 in one year's installations, the rate is 11.6%.

Defining the annual interest rate on consumer credit is the Senate's major contribution to truth in lending. Truth, in lending as in everything else, is relative, and writing the definition of true annual interest has not been an easy exercise in standards-making. Several different ways of calculating installment interest rates have been in common use. Each produces a somewhat different rate from the same set of terms, because each makes a different assumption about how the interest is being paid. For example, does all the interest come out of the first payment? Does it all come out of the final payment? Is it divided equally among all payments? Is it a decreasing portion of each payment?

In recent editions of the Buying Guide Issue of CONSUMER REPORTS, we have published an equation for calculating annual interest. It is based on the constant-ratio method—each payment is assumed to consist of a fixed portion of interest and principal, equaling the total of each divided by the number of installments. Most credit sellers, it turns out, use another method giving slightly different rates. It is a decreasing-interest method, which applies the interest rate each month to the unpaid balance. This method has been explained simply and clearly in the "Financial Rate Translater," a publication of rate tables for use by the credit industry:

"Traditionally the return on money invested is stated as an annual interest rate on the funds actually in use. For monthly payment loans the interest rate per month is 1/12 of the annual interest rate. In these tables we shall call this *annual* interest rate the *actuarial* rate. It is exactly the same rate you talk about for a G.I. mortgage, or an FHA mortgage or any other direct reduction loan. *The actuarial rate expresses the true return on an investment; any other is at best an approximation.*"