Chapter 5

DISCLOSURE AS A CONSUMER PROTECTION

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The common element of the federal government’s consumer-protection measures for financial services in the United States is the requirement that institutions disclose designated information to consumers in specified formats at required times. Disclosures are so central to the purpose of some financial consumer protections that we might properly call them “information protections.” The Truth in Lending Act (1968) is probably the most notable example, but others include the Real Estate Settlement Procedures Act (1975), the Home Mortgage Disclosure Act (1975), the Consumer Leasing Act (1976), the Electronic Fund Transfer Act (1978), and the Truth in Savings Act (1991). The main thrust of each of these laws is mandatory, designated disclosures. Moreover, even those federal financial consumer-protection laws that are not primarily information protections contain significant disclosure provisions. Statutes like the Fair Credit Reporting Act (1971), the Equal Credit Opportunity Act (1974), the Community Reinvestment Act (1977), and the Expedited Funds Availability Act (1987) largely entail direct regulation of the market behavior of institutions, but they also rely on disclosures to advance their objectives.

The importance of disclosures for policy is hardly surprising; ultimately, concern over incomplete information appears to underlie much or all of the demand for protecting consumers. If consumers always knew and fully understood the consequences of what they were doing, presumably they would make the right choices and need no further protection. Some consumers do not always fully understand transactions, however, and some get into various difficulties. Both situations generate calls for consumer protection, and government policymakers have tried various methods to answer these calls over the years.
Market observers have noted three potential advantages of disclosures over more direct methods of consumer protection. First, information protections often are compatible with existing market forces already at work to protect consumers. The marketplace provides incentives for sellers to make their products known, to disclose favorable pricing and product features, and to treat consumers fairly. Freely supplying useful information is one way firms can respond to these incentives. Required disclosures can help the process by providing for common standards and terminology, such as the Finance Charge and Annual Percentage Rate (APR) required under Truth in Lending. Mandatory standards then can enhance the power of existing market incentives, furthering consumers’ learning process, lowering costs, and making the market more efficient. Thus, disclosures in a standard format can help highlight the performance of the best institutions and expose the inadequacies of the poorer ones.

Second, as already suggested, if what consumers really lack is information, then it seems logical that consumer protection should focus upon providing what is missing. If consumers need information about pricing or terms of consumer-credit contracts, for example, then it seems more reasonable to require disclosure of the absent information than to regulate prices or contract features. Importantly, providing information rather than directly intervening in contracts or sales practices does not require that all consumers have the same preferences or that the government know, or presume to know, the product-feature desires of all consumers. The information approach also avoids some difficulties that arise with direct regulation. It is well known, for example, that direct financial-market interventions like regulation of interest rates and contract terms for credit produce their own sets of problems: they reduce consumers’ choices, create shortages in the marketplace, stifle innovation, and cause other disruptions. If information shortage is the difficulty in some situations, then helping to fill the information need seems like the proper response.

Third, required disclosures may be relatively lower in cost, both in terms of market disruption and out-of-pocket government expenditures, than other approaches to consumer protection. Lower expected costs in comparison to other protection approaches undoubtedly have been instrumental in encouraging adoption of disclosures as a convenient political compromise between those demanding greater consumer protection and those arguing that market interference is too wrenching and costly. Certainly, required disclosure has been a frequent outcome of the political process.

Whatever the reasons behind disclosure requirements (or the arguments and evidence supporting them), mandatory disclosure has become the main financial consumer-protection approach in the United States at the federal government level. In broad outline, federal statutes specify disclosures for consumer-credit prices and terms, credit denials, credit reporting, consumer leasing, deposits, electronic funds transfers, securities purchases, and geographic lending patterns of financial institutions. In each area the requirements are extensive and often complicated, sometimes