IMPROVING FEDERAL CONSUMER PROTECTION IN FINANCIAL SERVICES

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

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IMPROVING FEDERAL CONSUMER PROTECTION IN FINANCIAL SERVICES

Wednesday, June 13, 2007

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Present: Representatives Frank, Maloney, Watt, Ackerman, Sherman, Moore of Kansas, Clay, Miller of North Carolina, Scott, Green, Cleaver, Davis of Tennessee, Ellison, Klein, Wilson, Perlmutter; Bachus, Baker, Castle, Gillmor, Biggert, Barrett, McHenry, Campbell, and Bachmann.

The CHAIRMAN. The committee will come to order. There are vacant seats, so if there are citizens who would like to sit in the seats, please fill them. There are people waiting. We shouldn't have empty seats.

This is a very important hearing, in my mind, and it is one which I hope we will produce a lot of information. Contrary to the prevailing notion, sometimes Members of Congress have hearings because we want to learn things. I understand that is not the norm for hearings, but in this case, there is a need for information, and it is information to fill, in my judgment, a very clear-cut void.

The preemptions by the Comptroller of the Currency and the Office of Thrift Supervision were controversial. Many of us in Congress on both sides did not like them. A former colleague, the gentlewoman from New York, Ms. Kelly, for example, was a very strong critic of them on the Republican side. But reality sets in; those preemptions are not going to be undone in any substantial way. We have a President in power who would veto any effort to do that, and by the time we might get a different President, I do not think we could unscramble that particular set of eggs.

So I regret the scope of the preemptions. I acknowledge the extreme unlikelihood of our being able substantially to cut them back. There was some uncertainty until the Wachovia case was decided. Those of us who felt it was not an absolutely clear-cut decision take some solace in the fact it was 5–3; it would have been 5–4, I believe, if Justice Thomas had not recused, given his past voting pattern.

But the preemptions are in place, and that leaves us with the problem, in my judgment, that we, the Federal Government, have at this point bitten off much more than we are currently able to chew. Essentially to change metaphors a little bit, we have bitten

off 50 heads, but we don't have the brainpower ourselves to replace them. What we have done is to eliminate the major source of consumer protection in the financial area, because in the American system, for a variety of reasons, consumer protection has come primarily at the State level.

And let me, as an elected official, explain to people why there is an institutional reason for that, and why I am particularly concerned about the need to take serious action here. I want to say what may be imprudent, but making international macroeconomic supermonetary policy is more fun than arbitrating disputes between a cranky customer and a bank clerk. And it is much better to debate the Basel accords, or how going forward to do assignee liability in subprime, or any of a number of other issues that we have, the effect of monetary policy on employment, those are more stimulating intellectually, more rewarding than a, "He said, she said;" "I did not, yes, you did, no, I didn't," dispute.

There is a reason why consumer protection has been more often done at the State level; State regulators are more likely to be elected officials than Federal regulators—State attorneys general, State insurance commissioners, and other State officials. This is one case where being the closest to the electorate is a serious fact. And I will tell you, in my own office, and among Members of Congress, we do a certain amount of consumer protection because we run for office. And I will tell you this: If you ask me, where is the greater intellectual stimulation, where do I think any individual energy is that I express, where will I get greater results, it is probably in making broad national policy.

But cumulatively dealing with these individual consumer complaints is very, very important for two reasons: first, for the injustice done to individuals; and second, if there is no consumer protection mechanism in the society, things will go off track, and there could become this bias against consumers.

Now it is not that I believe that the banks and other institutions that are regulated are rapacious or greedy beyond the norm that we are supposed to have in a capitalist system. It is just that we all make mistakes, and even more of a problem, we don't like to admit our mistakes; we like to cover them up, we like to deny that we made them, and we like to blame other people for them. Those are human traits. I do not impute them to the banks; I impute them to human beings.

Consumer protection exists to be something of a corrective force, and here's the problem: I do not think that the Federal agencies as currently and historically constituted, given their mission, are at present adequately staffed or oriented or legally structured to provide consumer protection.

I had a conversation with one bank regulator who told me that the existence of safety and soundness powers—and, by the way, we will take 20 minutes on each side. We have only one panel. This is a serious issue, and so we are going to go to the fullest extent. However, I want to lay it out so that people have a sense of where we are on this. We are going to be within our 20 and 20. I was told by one of the regulators, well, we can do regulation of consumer protections under our power to enforce safety and soundness on the banks, the argument being that a bank that does not treat con-

sumers well can be called to account because it is jeopardizing its safety and soundness. I wish.

In fact, done cleverly enough, being unfair to consumers can contribute to the safety and soundness of a bank. I believe, for example, that the overdraft fees that people get hit with, where people go to an ATM and are told by the ATM that they have so much money, or they read on the ATM—I don't think we have talking ATMs yet. I guess we do for people who are vision impaired. But when people learn from the ATM that they have so much money—and that includes, without them having asked for it, an overdraft amount—and they write a check for that, they get whacked with a fee. I wish that jeopardized the safety and soundness of the banks who did it, but I see no evidence of that.

The fact is that banks are not stupid, and they do not do these things to put themselves at risk; they do them because they make money off of them. And they are there to make money and provide that money in our capitalist system to people who are invested in the intermediary function, but there are abuses.

So here are a couple of problems I want to examine. One, legally, do the various Federal bank regulators have the authority to step in and replace the regulations that were done at the State level? Two, do they have the proper resources for enforcement? There is no reason why these couldn't be changed. The fact is that even where State laws have applied, the visitation rights do not apply; States may not even enforce those laws where they can apply the law. Why? Are we the world's best—we, the Federal Government, are we such super-duper law enforcers that we don't need any help from anybody, and we can replace everybody else?

I think the opposite is the case. I think that cooperation in this area of law enforcement is a good idea. My colleagues want cooperation in other areas of law enforcement on immigration and elsewhere. I don't understand why we can say that all of these State regulators, with all of their experience, are totally incompetent to help us, the Federal Government, the all-wise, all-knowing, omnipotent Federal Government.

So we have the legal authority. We have the statutory powers. We also have the question of the culture, and I hope that is changing. And then we have this problem, and that is why I have asked all of you to be here together. And I am going to ask you all to keep your hands on the table so that nobody goes like this when we are asking why something isn't being done. You know, Harry Truman wanted a one-armed economist. I want regulators without fingers, because I don't want them being pointed at other people.

Here is the problem: We have been told by some of the regulators that they are not fully able to do regulation to the extent that we want because the Federal Reserve Board of Governors has not used their authority under the Federal Trade Commission Act to list things. That is why we appreciate Commissioner Majoras being here, with, by the way, I will say to you, the full acquiescence of Chairman Dingell, who has the primary congressional jurisdiction over the FTC. We have a combination. We are told, well, it is the FTC Act, and the Federal Reserve has their responsibilities under the FTC Act, and only they can give responsibilities to the other bank regulators.

Well, you are all here, and at the very least, when we leave today, we are going to know who does what, and who is responsible for what, and whether, in fact, the failure, as some have said, of the Fed to spell this out does interfere or not.

So that is where we are. I do believe that we have a common interest. I do believe that the people here before us from the Federal side do want to do consumer protection, but it is not primarily what you were instructed.

I have to say, and I am grateful that the Governor is here, but—let me give you this example. Former Governor Gramlich expressed a difference of opinion with former Chairman Greenspan about consumers, and Chairman Greenspan's response was very revealing. He said, "Oh, how can people say I wasn't interested in consumer affairs? I always followed the staff recommendation on that." Can anyone imagine Alan Greenspan saying, you know, when it came to interest rates, I always followed the staff recommendation? When it came to deciding whether there were problems in the stock market, I always followed the staff's recommendation? The fact that Alan Greenspan always followed the staff recommendation in consumer affairs is confirmation that this was not highest on his agenda. Alan Greenspan is not a man who is known for being staff-led. He was not known for his intellectual passivity. Yes, he goes to the staff, because he didn't become Chairman of the Federal Reserve, the supereconomic chiefdom of the world, to worry about a couple of people having an argument about a bank deposit in Chicago. And if we don't do that better than I think we would otherwise do it, then we are going to have a problem. So that is why we are here.

I now recognize the gentleman from Alabama. He has asked for 5 minutes. It is divided up. So I will just say to the clerks that he will have his time.

Mr. BACHUS. Thank you, Mr. Chairman.

Let me start by saying that I am a strong supporter of the dual banking system, and I think it has served our country well. Since the 19th century, where the OCC regulates our national banks the OCC, and then our Federal banks by the Federal Reserve and the FDIC, and our State agencies, the Supreme Court has basically preempted some State regulation on our national banks and established one national standard, which obviously provides a great deal of efficiency and ease of operation.

I think a national standard—OCC preemption—reduces the costs of the banks. It enhances, I think, their ability or at least their opportunity, to serve their customers, particularly in a global marketplace. However, critics have expressed concerns about—and it is a concern that I share—the adequacy of the OCC's regime for enforcing consumer protection. I wouldn't have said that 5 years ago; 5 years ago, I would have said that I am confident that regulation of our national banks and our State charter banks is sufficient. But recent practices have really called into question my judgment that customers are being well served, really, by both State and Federal regulators.

When we passed Check 21, we were assured by the regulators that this was a way to modernize our system, take cost out, which was an excellent opportunity to modernize and bring our banking

system forward. But we were told that it would not prejudice customers. Within 6 months, we began to get complaints that while checks were being debited to the account realtime, deposits were not. Deposits were being held until the next day.

I like to cite real examples. And again, a lot of the people who come to us with these complaints, it is the principle of the matter. I said that about credit cards. I had a gentleman who was getting work done at his house, he had a guy working there, and he paid the contractor an $8,000 check. Before he paid him, he actually said, "I have to go to the bank and make a deposit." He went to the bank, made a deposit, came back, and paid the contractor.

Well, it was about 2:30. The contractor went to a bank around 5:00 and deposited his check. It was the same bank where the gentleman had made his deposit. The deposit wasn't credited, but the check was, because the bank explained to the gentleman that after 2:00, it was the next business day for deposits, but not for checks. It was only the deposit which was the next business day. Now what really enraged this constituent of mine, and actually I probably had heard this on many occasions, was that his wife had written two small checks, one for $6 or $8, and one for about $18. Well, the bank could have paid those checks, but instead of paying those checks, they put the larger one in first so it would overdraw the account. He was actually told by his banker, and I confirmed this, that the bank had a computer program which took the larger check first to maximize overdraft charges. And, in fact, that has become a common practice to take the larger check when there are two or three checks presented at the same time. It maximizes the profit of the bank, but it obviously operates to the detriment of the client.

Now, a lot of the people who come to complain to me, they have time, they have money, they have resources, and it is not a life-or-death situation to them. But I am in a district that has counties where the median income is $18,000. After taxes, it is $12,000, and when someone writes three or four checks, and one overdraws their account, and the bank chooses to charge them for each of those three checks, that is $100. That can represent half of their disposable income for a week, and I see that as sharp practice. I see that as unconscionable.

You heard last week, many of you, in the last week or two, you had appeared before this committee on credit cards. Many of the practices—I have heard no one defend them as saying they are fair. I have had no one stand up and say this. I have had bankers and institutions that do it say, we realize there is a problem there, but no one is addressing the problem. And all of these practices are recent practices.

I talk to bankers in Birmingham. I talked to one of the gentlemen who established one of the large banks in Alabama. He said that as long as he was there—and he is in his 80's—the bank never would have done what is being done now. He said they wouldn't have even thought to have done such a thing.

I mentioned Check 21, clearing the checks, some of the credit card things. My fear with preemption, I think it can be a very good thing. It can only be a very good thing if Federal regulators both work with the State and coordinate their efforts to protect consumers, and they also get serious about some of these abusive

sharp practices which are not just fact. Yes, it increases the profits of the bank, but that shouldn't be—you know, that is not a justification for unfair practice. The customer has to have a seat at the table. And I would hope that Federal regulators would promote uniformity in Federal oversight, but also in strong consumer protection in both regulation and enforcement. I think that those are steps which will ultimately improve the bank's ability to serve their customers.

In this regard, the memorandum of understanding between the OCC and the Conference of State Banking Supervisors to facilitate proper referral of consumer complaints to Federal and State agencies with the regulatory authority is a step in the right direction, and I hope we will protect customers. But let me tell you what it won't protect, the two things that we keep saying that we have, and they are important, but they don't do the job alone. One is financial literacy. It is very important, but it is not an end-all, do-all, and disclosure is not an end-all, do-all. The idea that it is in the agreement, the customer was given notice of this practice, the chairman and I discussed yesterday. We are both law school graduates, we are very proud of our academic record in law school, and yet we get these disclosures, and we don't understand them.

The practice of the banks, to us, appears as something is simple, what we call sharp practice or unconscionable. And I do believe, and many of my Republican colleagues might disagree, but I do believe the Federal regulators: one, don't carry forward on the promises that they made to us when we passed Check 21; and two, if they do not start addressing some of these egregious practices, I do believe that the confidence of this committee and this Congress—if the Federal regulators in concert with State regulators don't protect the customers, I believe this committee will lose confidence and take action.

There are some on this committee who will never do that, they will never intervene. They will basically let the market sort it out between institutions and banks with a lot of financial resources and customers with almost no resources and very little ability to protect themselves. It is not a level playing field. And part of leveling that playing field is strong consumer protection. It has been a tradition of the Republican Party. It is a tradition I would like to see honored both on my side and on the other side. And I know these regulators; I know the people on the first panel. I know that they want to do what is right for the customer. Thank you.

The CHAIRMAN. How much time has been consumed by both sides? All right. We have 14 minutes left on this side. The gentleman has 9 minutes left.

I am going to recognize for 2 minutes the gentleman from Ohio, Mr. Wilson.

Mr. WILSON. Thank you, Mr. Chairman.

Let me start by saying, first of all, thank you for holding this hearing today, and I am pleased to be able to give an opening statement. Let me welcome our witnesses.

I am Charlie Wilson. I am from the Ohio Sixth Congressional District, and it is ironic we should be doing this today because just a year ago, I was in the Ohio Senate working on predatory lending. Ohio, ladies and gentlemen, has been a victim of predatory lending,

and unfortunately we lead the Nation, the entire Nation, in foreclosures. That is not something we are very proud of, and we are a proud State with 11.4 million people, and we do a lot of things right. So we sincerely want to get started on this at the Federal level.

As I said, last year we did Senate bill 185. We ran into some lame duck problems at the end of the session, and lost some of the teeth that were in Senate bill 185; however, we feel that we have made some strides toward helping. We realize it is a combination of problems that brings about the losses that we have.

Let me say that it is an honor to have representation of the Federal Reserve Board, the OCC, the FDIC, the Federal Trade Commission and all of you who are here today. Thank you for taking your time, and we hope to be able to get some direction and learn from you as to what we need to do. I say this not only as a State legislator, but as a former bank chairman, and a guy who spent the majority of his life on a bank board and saw it grow in great increments and did lots of things right.

I might say that when we did a lot of our investigation on the predatory lending that is going on in my home State of Ohio, it didn't seem to be the banks, it was more the subprime and the mortgage companies, and we found different things that were really being abused that we needed to address. So I really welcome the opportunity to hear from you today as to what protections we can put in, what we can do to be able to move the ball and be able to clear up this cancer that is in our society.

So I appreciate the opportunity to speak, Mr. Chairman, and thank you to the witnesses for being here today. I look forward to hearing from you.

The CHAIRMAN. I thank the gentleman.

Next, the gentleman from Louisiana is recognized for 5 minutes.

Mr. BAKER. Thank you, Mr. Chairman.

I wish to establish that I have been a preemption advocate for some time, so my position here is not necessarily inconsistent with past practices. I have challenged Attorney General Spitzer in his role as assuming the role of promisee in the securities marketplace. I was in the majority then, but I was in the minority, though, supporting that position. I have now cemented my position in the minority and continue to be in such a minority.

However, I think to attempt to balance the record just a bit, the issue of preemption begins in 1819 with *McCulloch* v. *Maryland,* when a State attempted to tax the Bank of the United States. This is not a revelation that has developed since the ATM machine. This is something that has been a customary practice for one principal reason: to provide stability in our capital markets and solvency among our financial institutions who engage in risk-taking by extending credit to those who qualify for the credit they seek.

Let us make clear that this is not about the OCC. The OTS has a long-standing authority for actions in preemption. In fact, during the early 1980's, a painful time in the real estate industry under President Carter, interest rates, prime, approached 21 percent, and States began to take action to prohibit individuals from transferring the terms of their mortgage to the new borrower in order to instill an artificially low interest rate environment while the prime

rate to the lending institutions themselves were 2, 3, 4, or 5 times the availability of the funds from the existing mortgage terms.

That was litigated all the way to the Supreme Court, and in the mid-1980's, it was held as a right of the OTS for the safety and soundness of the institutions involved and, I would point out, lost in this debate is the taxpayers of the United States who stand in good faith and ready to back up the losses of those institutions should they become insolvent. And need I remind everyone that in the late 1980's, we ultimately created the RTC, and many members of this committee spent many long hours derailing and bemoaning the actions of those thrifts in Louisiana and Texas which took extreme action to extend the losses to the American taxpayer. This is not incidental stuff. It has real-life consequences. Preservation and market stability is important. It is not necessarily just for those who are here at the table this morning.

The Credit Union Association, the NCUA, is not represented here this morning. They have the preemptive right to regulate not only nationally chartered, but State-chartered, federally insured credit unions. The National Federal Credit Union Act requires the regulation of federally insured, State-chartered credit unions to comply with certain provisions of NCUA's rules and regulations, not merely a regulator's action, but by action of this Congress. Therefore, to unwind the preemptive role of the NCUA from the function of regulating credit unions in this country, the Congress would have to act. We simply cannot beat up a handful of regulators and claim it is all at fault.

Beyond the question of the credit union, which I suggest would not likely be a helpful contribution to the overall debate this morning, an Executive Order issued during President Reagan's term, the great defender of free markets, said Federal action limiting the policymaking discretion of the State should be taken only when constitutional authority for the action is clear and certain that the national activity is necessitated by the presence of a problem of national scope. There is a way to define the need for preemption to preserve the integrity of our national capital markets while not at the same time obviating the States' ability to intercede on consumer protection advocacy. Both can be done, not mutually exclusive.

When we look back to the authorities of the OCC currently in question, there are areas where they are not now able to preempt contract law, criminal law, torts, actionable torts, in some cases the OTS, even in zoning matters. In other cases, the OTS doesn't match up exactly, but is similar in context.

So there is an obligation of the regulator for the sake of the United States taxpayer, whether a bank, whether a savings and loan, or whether a credit union, to act in a manner which is reasonable and prudent to ensure the continued solvency of that financial system. It does not, however, require that a regulator turn their back on actions which do not serve public policy well, and joining with State regulators can take action against those who engage in activities not for the common economic good or to the prejudice of the individual consumer.

If we can back this down a notch and focus our attention on where the real problem is, whether a State regulator can govern

the actions of a subsidiary of a national bank really should not be an issue. Whether you are in the main office in Chicago, or you are standing next to the potted plant in west Texas, it is the same institution governed by the same set of rules, and should they violate those rules, they will be held accountable by the national regulator; and should they engage in activities which are found to be cannibalizing the assets of normal, everyday, hard-working consumers, I will join with every other member of this committee in seeking out those problems and providing a Federal remedy, if necessary, if the States are unable to act.

But if the States are able to act, we should not get in their way. And I would assume—and questions of those on the panel this morning—we can determine whether they choose or will choose to intervene in consumer protection policies and intercede on the behalf of banks, or will you balance your judgment between the consumer and stability of our financial markets.

I yield back.

The CHAIRMAN. The gentlewoman from New York, the chairwoman of the Financial Institutions Subcommittee, is now recognized for 5 minutes.

Mrs. MALONEY. I thank the chairman for yielding and for organizing this incredibly important issue on the overarching issues of Federal and State consumer regulation. And I compliment you on the all-star cast of witnesses who are assembled today. And as you mentioned, the subcommittee which I chair is charged with consumer protections, so this is tremendously important to me, and I would say to all consumers and all Members of Congress.

Whether it is in the context of credit card regulation or subprime mortgage lending, the fact of growing OCC preemption requires us to ask who is best able to make new rules and who can enforce them.

I do want to mention that I have been involved and concerned about some of the abuses that Chairman Frank and Ranking Member Bachus highlighted. Chairman Frank mentioned the overdraft fees as an abuse, and I want to mention that I have legislation concerning this before Congress which would call for notice at ATMs on these overdraft fees.

And in the area that Ranking Member Bachus mentioned on deposit holds, I had a bill in last year to speed up deposit holds, and in this Congress I did not introduce it. I was awaiting the response from the Fed and their report on the bank adoption of Check 21 enforcement. But it is now clear that the Fed will not be regulating, or so they have said in their report, so I will be reintroducing my bill. I do want to note that Chairman Frank and I wrote a letter last week, literally, to the Fed urging them to regulate in this area.

On the issue that is before us today, it may be correct, as the OCC says, that the Watters decision changed the law very little, if at all, but in legal history books, I believe it will be seen as marking the end of one era and the beginning of the next. I hesitate to announce the impending death of the dual-banking system, but I wonder what meaningful role is left for State regulators. As an elected official, I believe very strongly in the statements earlier by Chairman Frank that elected officials are the most responsive

to the needs of the public, to the needs of their constituents and to the needs of consumers. And as a New Yorker, I know that an active State AG is a very effective consumer protector. On the other hand, in today's global market we may no longer be able to afford the luxury of having the most banking regulators in the world. Uniformity may be an advantage we can no longer afford to do without.

So I would like to see the Federal regulators prove that they can take up this responsibility and build a record on consumer protection to match the record they have built on safety and soundness. For instance, I would like to see the Fed use its authority in unfair and deceptive practices to regulate in both the subprime mortgage area and in the credit card area to ban abuses. As I suggested at last week's hearing, maybe we should extend the power to the other agencies as well so that there would be more regulatory vigilance. Joint rulemaking would give a seat at the table to the various sectors and provide more input and different views.

I would like to see the OCC and the FDIC ramp up their staffing and resources to make it possible for consumers to call and complain and get a helpful response. Structurally, I am concerned that the consumer protection sections of the agencies, that they should have direct access to the top decisionmakers and have a seat at the head table.

I also think we should support and encourage efforts by Federal regulators to work with States. For example, the OCC and the Conference of State Banking Supervisors have agreed on a model framework for sharing consumer complaints that has been put into place in my home State of New York with an MOU between the OCC and the New York State Banking Department. I understand that 17 other States have followed New York's lead and have gone forward with such agreements.

I hope we can explore these and other issues, and I very much look forward to the testimony on this critically important issue. And I yield back the balance of my time. Thank you, Mr. Chairman.

The CHAIRMAN. I thank the gentlewoman.

I will await the Ranking Member for the disposition of his last minutes, and I will recognize the gentleman from Kansas for 4 minutes.

Mr. MOORE OF KANSAS. Thank you, Mr. Chairman, for having this hearing, and again I want to also thank the witnesses who are here to testify and to help answer some of our questions about what we can do to address this issue.

Before I came to Congress, I was for 12 years the elected district attorney in Johnson County, Kansas, which is a suburb of Kansas City, and our office early in my tenure investigated and successfully prosecuted a national oil company charged with breaking gas pumps to cheat consumers. Things seemed to happen again and again.

We had problems then. We are having problems now. Consumers who file complaints with the consumer protection division of my office, which was really a very straightforward process, especially compared, I think, to the prospect of filing a complaint faced by banking customers today when they have a problem with their fi-

nancial institution—I don't think the average person has any idea where to file a complaint when something has gone wrong with their bank. In the past, a consumer who had a problem with a bank would often call the banking regulator or the attorney general's office, but the role has been significantly reduced in today's atmosphere.

When it comes to Federal regulators, I don't think most consumers have even heard the name of the several of them—Federal Reserve, OCC, NCUA, FTC, and OTS—and they all, I suppose, have seen the sign on the bank doors, FDIC, but they don't even know what these other institutions do. Even if the consumer knows the right Federal regulators, it is often then hard to find consumer complaint resources on the regulatory Web sites. Some of them require a great deal of searching to find a telephone number or complaint form. And when the consumer submits the complaint to the regulator, the process, I think, can be confusing and intimidating.

Our committee needs to feel confident that if consumers have fewer opportunities to go to State regulators for satisfaction, the Federal regulators are doing all they can to make this process as consumer friendly as possible and using what they learned from consumers to push financial institutions for better performance. Generally consumers are seeking assistance from regulatory agencies because they have experienced some level of frustration with their bank or their financial institution. We owe it to them to ensure that the process they encounter, the resolution they receive is not a source of greater frustration than the original complaint.

Again, thank you all for being here, and I hope we can work together and address some of these issues.

Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from Colorado is now recognized for 2 minutes.

Mr. PERLMUTTER. Thank you, Mr. Chairman. Thanks for the opportunity to make a statement this morning.

Recent actions such as *Watters* v. *Wachovia* give me some concerns because it weakens the role that States play in consumer transactions. The Supreme Court ruling, I believe, will make it more difficult for State banking consumer protections, which are considerably, in many instances, tougher than Federal measures, and I would ask those of you who are working with the various State regulators to continue to do that and allow for the States to continue to play a significant role in connection with consumer protection. In Colorado, we have really some good consumer protection laws, and some outstanding regulators, and the States must continue to play a role.

The other day Chairman Maloney convened a hearing on consumer protection and credit card practices, and I didn't get to speak until the very end, the third panel, and I missed many of you. But I went into sort of a tirade, and I will apologize for that now. But I did it because I come from a background representing banks and credit unions and financial institutions.

But I can tell you that in Colorado, there is a populist uprising. And Mr. Bachus, I think, hit it on the head, the chairman hit it on the head. Just looking at the regulation Z—and people were calling it the periodic statement. For me it is more confusing than

the periodic table because people are getting charged so many fees and such high rates. That is where we are coming from, whether it is the ATM charge—in Mr. Bachus' State, it is $39. Thank goodness in Colorado it is only $34. If you have a $2 overdraft, you get a $34 overcharge. If you have—you believed you paid off your card that month, but you didn't realize there was a double billing cycle, and you still have 50 cents. You don't pay the 50 cents, so you get a $25 late charge. That is what people are upset about.

The disclosures are fine and dandy if you can understand them because they are complicated. I mean, if you look at all the different fees just on the credit card regulation Z table, which we have simplified, it is still very difficult for anybody to understand, you know, not just the ordinary guy trying to make some kind of transaction.

So Mr. Baker is right about the preemption and the role of solvency versus the consumer. But what I think all of us are concerned about is that the consumer, the charges—somebody called it the other day risk-based lending. I call it profit-based lending. These fees make a lot of money for the financial institutions at the cost of the consumers, and they have gotten out of hand.

Thank you, Mr. Chairman. I will yield back.

The CHAIRMAN. All time has expired on this side. I believe we are through on both sides.

I sincerely apologize for the length of the statements, but I think it was important for all of you to know how—and I think on a bipartisan basis we express this—we feel this concern.

And we are now going to begin. No inferences should be drawn by the order. I never know exactly what the order was. Maybe people knew that our two chairs here would be color-coordinated, and they should be together. But for whatever reason, we will begin with Mr. Kroszner.

STATEMENT OF THE HONORABLE RANDALL S. KROSZNER, GOVERNOR, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. KROSZNER. Thank you very much. Chairman Frank, Ranking Member Bachus, and members of the committee, I really appreciate the opportunity to discuss the Federal Reserve Board's role in protecting consumers in financial services transactions with you today.

An important part of the Federal Reserve's mandate is promoting the availability of credit throughout the banking system. Equally important, the Federal Reserve has responsibility for implementing the laws designed to protect consumers in financial services transactions.

In carrying out its responsibilities related to consumer protection, the Federal Reserve has four complementary roles: First, we write rules to implement the consumer financial services and fair lending laws; second, we examine the financial institutions we supervise for compliance and as necessary take action to enforce the laws and resolve consumer complaints; third, the Federal Reserve actively promotes consumer education through its publications in a variety of partnerships with other organizations; and fourth,

through the community affairs program, we promote community development and fair and impartial access to credit.

In my oral remarks today I would like to focus on our role as rule writer. Many of the laws we implement are based on ensuring that consumers receive adequate disclosures about the features and risks of a particular product. When consumers are well-informed, they are in a better position to make decisions that are in their best interest. Effective disclosure also enhances competition and has the capacity to help weed out some abuses.

Advances in technology have fostered the development of products that are increasingly diverse, but also increasingly complex. While this has expanded consumer choices, it also presents a challenge to ensure effective disclosures about these complex products.

The Board is committed to developing more effective disclosures, and we have recently undertaken an innovative approach, namely using consumer surveys and testing in detail to understand consumers' needs in order to develop our regulatory response. Consumer testing can help us improve the effectiveness of disclosures by providing insight into consumers' understanding of financial products and their decision-making processes.

Given the complexity of some products, we must also be aware of the potential for information overload and design disclosures that not only are accurate, but clear and simple enough so that they are meaningful and useful to the consumers.

The Board is keenly aware that disclosures and financial education may not always be sufficient to combat abusive practices. The consumer laws implemented by the Board contain a number of restrictions, and the Board has the responsibility to prohibit other practices by issuing rules, for example, if the Board finds they meet the legal standard for unfair and deceptive practices. Crafting effective rules under the unfair or deceptive standard, however, presents a significant challenge. Whether the practice is unfair or deceptive depends heavily on the facts and circumstances of the individual case.

To be effective, rules must be broad enough to encompass a wide variety of circumstances so they are not easily circumvented. At the same time, broad prohibitions can limit consumers' options in legitimate cases that do not meet the required legal standard. This has led the Federal Reserve to focus primarily on addressing potentially unfair and deceptive practices through case-by-case determinations rather than through rulemaking. The Federal Trade Commission, which has authority to prohibit practices from financial services firms that are not depository institutions, I believe has taken a similar approach. Because prohibition on unfair or deceptive practices applies to all the depository institutions as a matter of law, the banking and thrift agencies can and do enforce prohibition using their supervised reinforcement powers.

The Board also addresses concerns about some practices under other statutes, such as the Truth in Lending Act and the Truth in Savings Act. For example, the Board adopted a rule to address so-called flipping of high-cost mortgages and revised the Truth in Savings Act rules to address concerns about overdraft protection programs.

In conclusion, the Federal Reserve takes its consumer protections responsibilities very seriously and is committed to addressing abusive practices. We will consider how we might use our authority to prohibit specific practices consistent with the legal standards in appropriate cases such as when there are widespread abuses that cannot be effectively addressed on a case-by-case basis. For example, tomorrow I will be chairing a hearing to examine how the Board might use its rulemaking authority to address practices in the subprime mortgage market. We must be careful, however, not to curtail responsible subprime lending. Any rules should be drawn sharply to avoid creating legal and regulatory uncertainty which could have the unintended consequence of substantially reducing consumers' access to legitimate credit options.

Again, I want to thank the committee very much for holding this hearing today, and I look forward to the questions that you have. Thank you.

[The prepared statement of Governor Kroszner can be found on page 159 of the appendix.]

The CHAIRMAN. Next we will hear from the Comptroller of the Currency, Mr. Dugan.

STATEMENT OF THE HONORABLE JOHN C. DUGAN, COMPTROLLER OF THE CURRENCY, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Mr. DUGAN. Chairman Frank, Ranking Member Bachus, and members of the committee, I welcome this opportunity to discuss consumer protection. As the Federal Reserve just said, the OCC also takes this responsibility very seriously, especially since retail banking has become a much larger part of the activities of national banks.

Frankly, our comprehensive approach to consumer protection, integrating guidance, supervision, enforcement, and complaint resolution is just not well understood. The fact is consumer protection is a fundamental part of the OCC's mission, and we are not simply a safety and soundness regulator as some have suggested. OCC supervision plays a unique and critical role in ensuring compliance with Federal consumer protection standards. Our extensive and continual presence in national banks, from large teams of resident examiners at our largest banks, to our frequent on-site examinations of our community banks, allows us to identify and fix consumer compliance issues early before they become major problems. As a result, our compliance regime is not enforcement only. Instead, it is better described as supervision first, enforcement if necessary.

With supervision addressing so many problems early, that formal enforcement often is not necessary. For this reason, the number of formal enforcement actions taken by any bank supervisory agency is a misleading measure of the effectiveness of its consumer compliance regulation. Yet when we have needed to take strong enforcement action, the OCC has not hesitated to do so, often providing new standards to protect bank customers.

The OCC also has developed a robust process for addressing consumer complaints. Our Customer Assistance Group integrates skilled professionals and up-to-date technology to redress indi-

vidual problems, answer questions, educate consumers, and support our consumer compliance supervision.

While we believe this comprehensive approach is effective, it does have three significant limits: statutory limits set by Congress, rule-writing limits in that the OCC has no authority to write most consumer protection regulations; and jurisdictional limits in that our authority obviously only extends to national banks.

Let me also briefly share our view of the Supreme Court's recent preemption decision. The Watters case does not mark a shift in prevailing law, but it does clarify responsibility and accountability. In particular, it makes clear that Federal and State regulators both have important jobs to do, but they are different. Ours is to regulate and supervise national banks for which we should be held accountable. Theirs is to regulate State-chartered entities for which they should be held accountable.

And to those who argue that there should be both Federal and State supervision of national banks, that there can never be too many cops on the beat, I must respectfully disagree. We believe it is counterproductive for States to focus their finite enforcement resources on national banks that are already heavily regulated, especially when there are lightly regulated State entities, like many subprime lenders and mortgage brokers, that clearly have been the source of real problems. You can indeed have too many cops on the same beat if it means leaving other, more dangerous parts of the neighborhood unprotected.

We believe consumers benefit most when the OCC and the States focus on our respective areas of responsibility and find productive ways to cooperate. The OCC is doing just that. For example, since last November we have reached agreements with 18 States, as was mentioned earlier, to refer and share complaint information. Similarly, the OCC and the other Federal banking agencies have cooperated with the States to extend the coverage of the nontraditional mortgage guidance and the proposed subprime lending guidance.

I am also very pleased to announce another cooperative initiative today on mortgage brokers: parallel examinations of national banks regulated by the OCC and the mortgage brokers that they use regulated by the States. This intersection of our regulatory jurisdictions provides a real and useful opportunity to coordinate our efforts, especially given the recent criticism of mortgage broker practices. Though still in the early stages, and limited in scope, both we and the Conference of State Bank Supervisors believe this new initiative shows real promise.

Finally, my testimony provides the following suggested improvements to Federal consumer protection regulation: First, joint agency authority, including for the OCC, to write regulations defining unfair and deceptive practices applicable to banking organizations; second, a requirement that an agency charged with writing consumer protection regulations consult before issuing such regulations with the regulators charged with implementing them; third, a requirement that consumer protection regulations be revised and updated more regularly than they are now in order for the regulations to keep pace with change; and fourth, the development of a centralized Web site for complaints by consumers of any banking

institution regardless of charter to help eliminate much of today's confusion.

Thank you very much. I look forward to answering questions.

[The prepared statement of Comptroller Dugan can be found on page 120 of the appendix.]

Thank you, Comptroller.

And next, the Chairman of the Federal Deposit Insurance Corporation, Chairman Bair.

STATEMENT OF THE HONORABLE SHEILA C. BAIR, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Ms. BAIR. Chairman Frank, Ranking Member Bachus, and members of the committee, I appreciate the opportunity to testify on Federal consumer protection in financial services.

The U.S. financial system has undergone a significant change in recent years. Consumers overall have benefited from the huge number of new and innovative products and services they can now choose from. But along with all this consumer choice has come more complexity in product terms and cost structures. This complexity has created financial pitfalls for the unsophisticated and unwary. We also see many new players in the market, many of them beyond the reach of Federal regulatory agencies.

The greatest weakness in today's financial marketplace is the absence of clear consumer protection standards applied uniformly to all participants in the market. As you know, consumer protection is a key part of our job at the FDIC. We closely examine our banks for compliance with consumer protection laws and regulations and take enforcement actions where warranted. We also devote significant resources to investigating and resolving consumer complaints. And we carefully monitor and analyze consumer complaints to signal problems in particular services or financial institutions.

We have several recommendations for improving Federal consumer safeguards that would provide stronger, more uniform protections and help level the playing field. First, as I have previously testified, the FDIC supports national standards for subprime mortgage lending by all lenders through HOEPA rulemaking or by statute. Ideally, national standards would include a number of elements which I detail in my written testimony, such as requiring underwriting at the fully indexed rate, restrictions on prepayment penalties, and restrictions against misleading marketing.

Second, Congress should consider expanding rulemaking authority to all Federal banking regulators to address unfair and deceptive practices under the FTC Act, not just to three of the five regulators, as is the case under current law. This change in law would include the prospective input at the FDIC and OCC in rulemaking to protect consumers; together, we account for about 7,000 banks.

Third, to enhance enforcement of Federal consumer protection laws, Congress could consider expanding the Truth in Lending Act as well as the FTC Act to allow State authorities to enforce those laws against nonbank financial service providers. Nonbank providers are a significant portion of today's market. Allowing more regulators to enforce these laws would beef up compliance.

Finally, I am a big believer in financial literacy. Educated consumers are better able to make sound choices and protect them-

selves against scams. Integrating financial education into existing public school curriculum, such as in math classes, would help kids from all income levels and expose them to basic financial principles year after year. There are a number of Teach the Teacher programs offered at many universities to assist school systems in integrating financial education into core curriculum, but such programs could greatly benefit from Federal financial support.

In conclusion, I would say that market competition is the best way to set prices and allocate resources. However, markets need rules. Abusive or misleading financial practices not only hurt consumers, they hurt the reputation of the entire industry. The FDIC stands willing to assist you and our fellow regulators in finding ways to serve the needs of consumers and the markets. Thank you, and I would be happy to answer your questions.

[The prepared statement of Chairman Bair can be found on page 91 of the appendix.]

The CHAIRMAN. Next, the Chair of the Federal Trade Commission. And Chairwoman Majoras, we know we are not your usual venue, so we very much serious appreciate you doing this. But it did seem to us that having all the regulators together is really the prerequisite, and we hope that this won't be the last time you all will be together talking about this issue. Madam Chairwoman, please proceed.

STATEMENT OF THE HONORABLE DEBORAH PLATT MAJORAS, CHAIRMAN, FEDERAL TRADE COMMISSION

Ms. MAJORAS. Chairman Frank, Ranking Member Bachus, and members of the committee, I am pleased to be here with you and with my colleagues today.

Because financial issues affect all consumers, whether they are buying a home, trying to improve their credit rating, or dealing with rising debt, protecting consumers of financial services is a key part of the mission at the FTC.

Now, of course, the FTC is primarily a law enforcement agency. We don't have the same sort of supervisory authority over particular entities that some of my colleagues here have. And, of course, we don't have jurisdiction over banks. But under the FTC Act and several other consumer protection and financial statutes, the Commission has broad jurisdiction over nonbank financial companies, including nonbank mortgage companies, mortgage brokers, finance companies, and some units of bank holding companies.

The FTC uses three main tools to protect consumers: law enforcement; consumer education; and policy research and development. We focus our investigations and prosecutions on combating and preventing unlawful acts and practices that are most likely to cause consumer harm. Recently in this area, we focused on the following: mortgage lending and servicing; nonmortgage lending and leasing; gift card sales; advance fee loan scams; debt collection practices; credit and debt counseling services; and credit reporting.

The Commission has targeted deceptive or unfair practices in all stages of mortgage lending, for example, from advertising and marketing through to loan servicing. In the past decade, the FTC has brought 21 such actions, focusing particularly on the subprime market.

As a result of these actions, courts have ordered the return of more than $320 million to consumers. And because law enforcement is highly effective, indeed, it is most effective when government agencies cooperate, we have done so whenever possible and appropriate. For example, we brought an action against Fairbanks Capital Corp., one of the country's largest third-party subprime loan services a few years ago with HUD. We charged that Fairbanks failed to charge consumers' payments upon receipt, charged unauthorized fees, and reported consumer payment information that it knew to be inaccurate to the credit bureaus. And Fairbanks and its former CEO paid over $40 million in consumer redress.

Attacking debt collection abuses is another critical part of our agenda. Today, I am announcing the Commission's 20th debt collection case since 1998. This week, the FTC filed an action to stop debt collectors who targeted Spanish-speaking consumers and engaged in repeated egregious violations of the Fair Debt Collection Practices Act. The case has been filed under seal, and we are waiting for the judge to rule in our request for a temporary restraining order.

Another recent area of enforcement has been gift cards, and we recently brought two cases against sellers of gift cards that carried concealed fees. Both Kmart Corporation and Darden Restaurants agreed to settle claims that they engaged in deceptive practices and advertising in selling gift cards and are now implementing programs to either refund consumers or restore fees that were deducted from the consumers' gift cards.

Now, while law enforcement is essential, consumers are best served if they can avoid the injury in the first place. To empower them to avoid the harm, we have developed extensive consumer education programs addressing financial services focusing on expanding the reach of these materials to get them out there.

In the last fiscal year, we distributed over 4 million printed copies of financial education brochures, and had over 6 million hits on the same publications on our Web site. In addition, we have educated young people who have limited experience with credit by conducting outreach on college campuses, at local district college fairs, and in high schools, including local high schools here in the District.

Of course, financial services markets are dynamic and continue to evolve, and recognizing that, we and other policymakers must continually assess how we adapt our policies and practices, and how we engage in research and policy development concerning financial services and consumers.

And today the Commission's Bureau of Economics released a study that confirms the need to improve mortgage disclosures. The key findings of that study, which we have with us here today, are: first, that the current federally required disclosures fail to convey key mortgage costs to consumers; second, that better disclosures—there was a prototype that our economists used—can significantly improve consumer recognition of the various costs; third, that both prime and subprime borrowers fail to understand key loan terms, and they benefited from improved disclosures; and fourth, not surprisingly, that improved disclosures provide the greatest benefit for

more complex loans, whether they were prime or subprime. We look forward to working with our colleagues on the next steps.

Looking ahead to October, the FTC, in response to a growing number of complaints about the practices of debt collectors, is holding a public workshop to examine changes in debt collection and the impact on consumers and competition, and we hope whatever we learn there we can use to assist policymakers in developing further laws, policies, and procedures.

Mr. Chairman, and members of the committee, I appreciate the opportunity to provide the FTC's input today, and I assure you that you have our commitment to work tirelessly for the consumers of this Nation. Thank you.

[The prepared statement of Chairman Majoras can be found on page 180 of the appendix.]

The CHAIRMAN. Next we have Scott Polakoff, the Deputy Director and Chief Operating Officer of the Office of Thrift Supervision.

STATEMENT OF SCOTT M. POLAKOFF, DEPUTY DIRECTOR AND CHIEF OPERATING OFFICER, OFFICE OF THRIFT SUPERVISION

Mr. POLAKOFF. Good morning, Chairman Frank, Ranking Member Bachus, and members of the committee. Thank you for the opportunity to present the views of OTS on the adequacy of consumer protections in financial services.

Consumer protection, maintaining the safety and soundness of the thrift industry, and ensuring the continued availability of affordable housing credit are three critical responsibilities of the OTS.

On the subject of today's hearing, consumer protection, there are four important components detailed in my written statement. Briefly, effective consumer protection by regulators requires: Number one, an emphasis on consumer protection in both the examination process and the application process; number two, an effective supervision program including the use of formal and informal enforcement actions to address threats to consumer protection; number three, a robust consumer complaint mechanism to address issues as they arise and to use the information in the supervisory process; and number four, effective training and continuing education of examiners regarding consumer protection issues.

OTS has a consolidated examination structure that is unique among the Federal banking agencies. The program combines our safety and soundness and compliance examinations to better address institutions' risk during the exam process. Part of the rationale for this approach is that compliance and safety and soundness go hand-in-hand. We believe this provides a more comprehensive assessment of an institution's risk profile, more accurately exposes weaknesses and deficiencies in an institution's overall program, and provides us with an accurate assessment of an institution's overall business strategy.

Our examiners are subject to an intensive cross-training program to acquire the knowledge and skills needed to lead a melded examination. We also maintain a cadre of compliance experts to assist examination teams in handling complex compliance matters.

Because Federal thrifts may conduct their lending and deposit-taking programs subject only to the requirements of Federal law, the OTS is required to ensure that Federal thrifts conduct their activities and programs in compliance with applicable consumer protection laws and subject to rigorous scrutiny of all aspects of an institution's program.

We regularly examine risks for compliance with Federal protection statutes including the Truth in Lending Act, HOEPA, RESPA, the Truth in Savings Act, ECOA, the Fair Housing Act, and the Credit Reporting Act, among others.

We also continually track, investigate, and respond to consumer complaints involving thrift institutions. We follow up with the institution on all consumer complaints filed with the Agency, and we typically process and conclude consumer complaints investigations within our 60-day timeframe.

In addition, this data plays a significant role in identifying areas to focus on during on-site examinations in assessing the adequacy of an institution's overall compliance management program and in pursuing corrective action that may be appropriate to address programmatic weaknesses or deficiencies.

I should also mention that we have finalized the model memorandum of understanding with the Conference of State Bank Supervisors to share consumer complaint data between the OTS and State banking supervisors.

When an institution's lending programs are found to be potentially predatory or lacking adequate controls to support responsible lending, there are numerous options that OTS can take to stop these practices and correct the situation. These include formal enforcement actions and informal agreements. While we find informal actions to be an effective mechanism to address these types of supervisory concerns, we do not hesitate to use our formal enforcement authority when appropriate.

Fundamental to our continuing oversight of the industry we regulate is ensuring that institutions conduct their activities in a manner consistent with sound consumer protection. In my written statement we describe various programs, publications, and initiatives that the OTS has worked on its own and cooperatively with various other agencies and organizations to promote consumer education and responsibility. We also have various initiatives to improve financial literacy, and we work closely with our institutions to encourage them to do the same.

Regarding the adequacy of our existing authority to address consumer protection issues and potential abuses that may arise going forward with the programs of OTS-regulated thrifts and their affiliates, I believe our authority is complete and adequate. I do not believe that an additional statutory authority is necessary at this time for OTS to continue to effectively supervise, regulate, and enforce Federal consumer protection laws.

I look forward to answering your questions and thank you for the opportunity to comment.

[The prepared statement of Mr. Polakoff can be found on page 219 of the appendix.]

The CHAIRMAN. Next to represent those involved here, the attorney general of the State of Iowa, who has been active with the

other State attorneys general, and I believe speaks for many of them today, Mr. Tom Miller.

STATEMENT OF THE HONORABLE THOMAS J. MILLER, ATTORNEY GENERAL, STATE OF IOWA

Mr. MILLER. Thank you, Mr. Chairman. Mr. Chairman, Ranking Member Bachus, and members of the committee, thank you for inviting me, and thank you for listening to the views of myself and State attorneys general.

The Watters case, I suppose we could debate whether it changed the law or reaffirmed the law, but that debate is over. What has happened, though, over the last 5 to 8 years is that the practice has been changed, the practice of the role of State AGs and State banking superintendents, in dealing with consumer complaints in the banking area and related areas. For decades, we dealt with those complaints, we dealt with those issues. Now we are prohibited from doing so in many instances. So the practice has changed considerably under the direction and institution of the OCC.

So we—like the chairman, like CSBS—think the law should be changed. We think the States should have the role that they played for decades, really, starting from the 1960's on, with consumer protection, but we recognize that the law probably won't be changed. I think the chairman stated the political realities very, very well. So what happens next?

I think the huge challenge for the Federal people is the volume of complaints. This is the potentially intractable problem—probably millions of complaints each year, some of them not heard, but out there and maybe will be heard by the Federal regulators. How do they deal with those complaints? Now many of those complaints at a national level don't have a lot of significance, but for that individual person, it has a huge amount of significance. That is their challenge.

Now, what do we, State attorneys general, think might be done? Well, first of all, they have considerable rulemaking power that generally in the past has not been used, in part because I think they thought the States were doing these kinds of activities, and we were. So they have rulemaking authority. And they have enormous power because of their regulatory authority over the various banks and institutions. So that is an enormous opportunity, but they can't be reticent, for whatever reason, to use their authority.

Recently, as a result of a New York Times story, the demand draft issue has come forward where people can send through demand drafts, checks that are unsigned, if they get the bank account number, and clean out a person's account. Well, that is something the Federal regulators can take care of. In that story, it indicated that the bank involved, 59 percent of the checks were returned. Well, consumer protection people would tell you if it is 2 or 3 or 4 percent, that is fraud in the biggest, strongest possible letters as a warning signal. So the Federal regulators need to figure out where the banks—when they get a certain percentage of checks returned for those reasons, they have to investigate, and invariably they will find fraud. And frankly, if they do that, they can do in this area more than the State attorneys general and do it more effectively.

Another area is what I call soft-core fraud dealing with membership clubs and getting people in membership clubs and banks giving the names and sharing the profits. Banks shouldn't be doing that. They shouldn't be using their names. The regulators can stop that, and, again, more effectively than the States.

The Federal regulators have to get the expertise in consumer protection. They have some, but they need a lot more, because as a practical matter, they have a lot more responsibility. They can draw perhaps on former State officials that dealt with this area, and many others, to build up their expertise in the consumer area. And it is also a matter of focus. The chairman was, as always, brilliant on that, that the focus has been safety and soundness. The focus of consumer protection with this increased role has to increase at the agencies.

And finally, in terms of complaints, I go back to that, that is something that in an informal way we might help on. But in any area where there is problems and challenges, there is opportunities, and I think there is one amazing opportunity that is present today, and that is for all of us to work together in the subprime area and on predatory lending. That is an area where we still have some considerable authority. And if we work together, what has happened is that some of the bad actors are out of business; some of the better actors are continuing in business and have reputational issues. There have been problems that have been raised for the country. There has been pain for both consumers and investors. This industry, which is a chronic one, could be cleaned up if we all worked together—meaningful, not just lip service, but we got together, shared our expertise and shared our power, figured out on an ongoing basis at a staff level—I have a a guy, Patrick Madigan, who works this all the time. He understands it completely. There are other people in the State offices and in the Federal offices. If they worked on it on an ongoing basis, and the principals, the elected officials, the appointed officials, came in at the appropriate time, we could clean up the subprime industry if we worked together, and if we had the will to use the powers that we all have on a complementary, comprehensive basis.

Thank you, members of the committee.

[The prepared statement of Mr. Miller can be found on page 205 of the appendix.]

The CHAIRMAN. And now my own State bank commissioner, Commissioner Steven Antonakes, from Massachusetts.

STATEMENT OF STEVEN L. ANTONAKES, COMMISSIONER OF BANKS, COMMONWEALTH OF MASSACHUSETTS, ON BEHALF OF THE CONFERENCE OF STATE BANK SUPERVISORS

Mr. ANTONAKES. Good morning, Chairman Frank, Ranking Member Bachus, and distinguished members of the committee. My name is Steven Antonakes, and I serve as the commissioner of banks of the Commonwealth of Massachusetts. I am also the chairman the FFIEC State Liaison Committee. It is my pleasure to testify today on behalf of the Conference of State Bank Supervisors.

I commend you, Mr. Chairman, for calling this hearing to discuss consumer protection and financial services. The States have long been recognized as leaders in providing consumer protection. CSBS

is committed to working with Congress and our Federal counterparts to further the development of a fair and efficient system of consumer protection that serves the interest of financial services customers.

As you may know, nearly every consumer protection that exists at the Federal level or that Congress is currently contemplating, has its roots in State law. However, as the result of OCC and OTS interpretations supported by the courts, it is unclear if the States will continue to have the ability to serve as the laboratory for innovation for banking consumer law.

Maintaining a local role in consumer protection and a strong State banking system is more important than ever as our Nation's financial system consolidates. As the Nation's largest banks become less connected with the communities they serve, they are also finding ways to become less accountable to those communities through preemption of State law and law enforcement. CSBS believes that the effective supervision of the financial marketplace requires a coordinated effort among the Federal agencies and the States.

Ultimately the goal for Congress and the regulators should be to create an efficient supervisory structure that allows institutions to compete effectively and to make their products and services available to a broad demographic while offering effective consumer protection and recourse against fraudulent and abusive practices.

Recently the States, through CSBS, agreed to a framework for the sharing of consumer complaints and resolutions between State agencies and the OCC and the OTS. CSBS and the OCC are also working with the other agencies to develop a model consumer complaint form. In addition, I look forward to working with Comptroller Dugan to coordinate examinations of national banks and State license brokers and originators.

These are all positive steps to improve service to consumers, however, these efforts do not address our fundamental concern about the impact of OCC and OTS preemption on how consumer protections are developed and how they are enforced.

Recognizing that only Congress can address our concerns, we would suggest the following:

Congress should require that the FFIEC write regulations and guidance for consumer protection. This will allow the States to have more input in the process and result in more consistent standards for consumers.

Congress should give the FFIEC rule-writing authority for unfair and deceptive acts and practices.

Congress should consider creating a centralized system for the collection and distribution of consumer complaints to the appropriate regulators.

Additionally, banks and their subsidiaries should disclose who their primary regulator is and how to address consumer complaints to that specific regulator.

We ask that Congress direct the Federal banking agencies to list applicable and preempted State laws. The Riegle-Neal Interstate Branching Act stated that the OCC shall enforce applicable State consumer protection laws. It is important that banks, the States, and consumers know which State laws are being enforced and which have been preempted.

Congress should clarify State enforcement authority and the limits of applicable State law for federally chartered institutions. State legislators and attorneys general need a clear statement of their roles in protecting the citizens of their States. The current state of confusion is not acceptable.

And Congress should encourage Federal and State coordination to develop consistent interpretation and enforcement of applicable State laws.

I urge Congress to continue its examination of the adequacy of OCC and OTS consumer protections and enforcement. The States, through CSBS and our involvement on the FFIEC, want to be part of the solution. We want to ensure that consumers are protected regardless of the chartering agent of their financial institution. We want to preserve the viability of both the Federal and State charter options to maintain a meaningful choice in charters and the success of the dual-banking system.

Thank you for inviting me to testify. I look forward to your questions.

[The prepared statement of Mr. Antonakes can be found on page 67 of the appendix.]

The CHAIRMAN. Thank you.

I am going to swap places with the gentleman from Kansas, Mr. Moore. He will ask in my place, and I will wait until he would have been reached. I recognize the gentleman from Kansas.

Before that, I want to introduce into the record a letter from the National Association of Insurance Commissioners, by unanimous consent, in which they say, "We would like to share with you some of the examples of the negative effects of Federal preemption on State regulation of health insurers." They acknowledge that we don't have health, but they are expressing their concerns about the negative effects of preemption in that area. That will be part of the record.

The gentleman from Kansas.

Mr. MOORE. Thank you, Mr. Chairman, for swapping time with me here.

I want to ask a question of Mr. Dugan. Pages 21 and 22 of your testimony indicate that data derived from your customer assistance group are used in identifying problems at banks. OCC claims that it fields 70,000 inquiries and complaints each year compared to the OTS, which received 5,200 complaints in 2006, and the Fed, which received 1,900 in each of the last 2 years.

And I want to refer to a GAO report in February of 2006 which says, in reporting its performance, OCC includes data on its response to consumers' inquiries which typically take less time, thereby overstating its performance on timeliness to responses or complaints.

Could you break down that number, that 70,000 number, for me in terms of inquiries versus complaints? Can you give examples of enforcement actions, formal or informal, that originates from consumer complaints? Can you break down the number first, sir?

Mr. DUGAN. I can get the number on breaking it down for complaints versus inquiries in just a moment, but we don't trace which inquiry leads to a formal or informal enforcement action. More often than not, these lead to situations where we assist the con-

sumer by resolving a dispute and providing financial relief. We have tracked and provided over $30 million of financial relief to consumers in the last 5 years that was facilitated through that process.

Mr. MOORE. You are familiar with this GAO report in February of last year, correct?

Mr. DUGAN. Yes, I am familiar with it. I am not sure these are the same ones that you are talking about, but it is the 41,000 inquiries and 29,000 complaints. I am not sure that is the bar that you were looking at.

Mr. MOORE. That is really what I was looking for.

Mr. DUGAN. And we are very familiar with that recommendation. We do break that down directly like that now as a result of the report. We are quite conscious of that.

Mr. MOORE. Thank you.

According to this GAO report, OCC agreed with the conclusions and recommendations.

Mr. DUGAN. Yes, sir.

Mr. MOORE. You are going to follow that?

Mr. DUGAN. Absolutely.

Mr. MOORE. I appreciate that.

I am pleased that some of you mentioned in your testimony, and the attorney general mentioned in his testimony, that you are working toward the goal of a uniform consumer complaint. I think OCC talked about that and OTS and FDIC in your reports. While you are developing this uniform complaint, which I think is great, wouldn't it be helpful to create a single toll-free number—any comments by any of the panelists on that—so people who had a problem with their financial institution would know where to go?

I looked at some of the Web sites, and it is very, very confusing and takes several clicks sometimes to get to a complaint form or a toll-free number. Any comments about a single toll-free number that maybe all financial institutions could use?

Mr. DUGAN. Speaking for the OCC, I think this is an idea definitely worth exploring. We have had some preliminary discussions in a forum. I think the FTC actually has a number that they use in these sorts of circumstances. It is more complicated than it first sounds, but we can do more as a group to have a centralized, easy-to-understand, easy-to-find function. And as my testimony indicates, I really do think we should pursue that.

Ms. BAIR. Could I add, since we are the deposit insurer, the FDIC logo is displayed in all banks and thrifts. Because we recently needed to change our logo due to the merger of two of our funds, our Web site and all the information that is sent out about the FDIC is displayed at banks and will have our Web site address on it.

Anticipating your question, it only took us two clicks to get to the complaint form on our Web site. But if we could improve that and put the complaint form on the FDIC home page, I am happy to do that. But I do think that de facto we serve as a clearinghouse now because a lot of people come to us because they know our name. We would be happy to expand upon that role.

Mr. MOORE. Any other comments by panelists up here? Mr. Kroszner?

Mr. KROSZNER. We also have been moving towards having a single 800 number for all the Federal Reserve banks, because we have a system of 12 regional Federal Reserve banks. Rather than have the customer try to find the regional Federal Reserve bank that is appropriate to them, by 2008 we will have a centralized clearinghouse with one number for everyone to call. I am very much supportive of that idea.

We also now have a beta version of the Web site up that if you have your institution's name, you can type that institution's name in, and it will tell you whether it is a Federal Reserve supervisor, an FDIC supervisor, or an FCC supervisor, etc. Also, if you call that 800 number, there will be a person who can tell you if it is a Fed institution, or it is an OCC or other institution, and then direct the person directly to that. But I think it is extremely valuable that we do this, and we are working towards that end.

Mr. MOORE. A real person you are talking about that consumers can talk to?

Mr. KROSZNER. A real person, not a series of, "Press 5 if you would like to wait for 5 minutes."

The CHAIRMAN. In what country will this real person be working?

Mr. KROSZNER. I believe—this will be up in 2008, but I believe that real person will be working in the United States.

The CHAIRMAN. That is reassuring.

The gentleman from Alabama.

Mr. BACHUS. Thank you, Mr. Chairman.

Comptroller Dugan, you mentioned the importance of working with State officials. Could you give us some greater detail on areas where you have worked with them or you are open to working with them in the future?

Mr. DUGAN. Absolutely. As I mentioned, we have been trying for some time to figure out a way to share consumer complaint information, and, last November, after a series of meetings and good cooperation of the Conference of State Bank Supervisors, we adopted a model memorandum of understanding where we can share information about complaints, get referrals, and report back on the disposition of information. And, as a result of that, we entered into an agreement first with the State of New York, and since then with 17 other States, and we are pursuing that with a number of other States.

We have entered into similar agreements with 14 State insurance commissioners. When we did our nontraditional mortgage guidance, it became apparent that a huge part of the mortgage business is being conducted at the State level, not just by non-national bank people, but by nonbank-affiliated lenders. Over half of the subprime mortgages were issued there, for example, and it became very important for us to have some kind of agreement by States to adopt similar rules for that.

Lastly, as we just announced today, we have spoken with Commissioner Antonakes and the State of New York's commissioner, Superintendent Neiman, to try to develop a way to look more closely at State-regulated brokers that originate mortgages that are used by national banks, and have parallel examinations where we can share information. I believe this will be particularly important going forward to make sure this new guidance is being imple-

mented not just by employees of the banks that we supervise, but by the brokers that they use and with whom the banks don't necessarily have the same kind of contact as they do with their own employees.

Those are several types of things. We are open to other kinds of suggestions. We welcome them.

Mr. BACHUS. Complaints that OCC has not taken any enforcement actions, does that indicate you are not doing your job?

Mr. DUGAN. No. It is something I did try to spend some time discussing in our testimony. First of all, we do take enforcement actions. We are not an enforcement-only regime as is the case in many places that don't have regulated institutions.

We, because of our extensive presence in the banks that we supervise, which is also true of the other bank regulators, are able to effect change much more quickly in a way that never reaches an enforcement action. We have a series of graduated steps that we take to effect corrective action beginning with something called a "matter requiring attention." And, if you look at our record over the last 5 years, which we did in anticipating this hearing, we totaled up the number of formal enforcement actions that we took in consumer-related issues. It is about 200. Similarly we took about 200 informal enforcement actions on consumer issues. But if you look at the "matters requiring attention" that start this process, there were 1,500 of them. And that is what you want to see. You want to see identification early of what those problems are, telling management to fix this, and they don't result in enforcement actions but instead result in correction.

The problem for us is that as a public relations matter, people don't see that. And that is the point really I am trying to get across, which is you can't measure how well we do what we do in this area by only looking at formal enforcement actions.

Mr. BACHUS. All right. Let me ask the total panel, anybody, if you would like to comment. Neither the OCC or the FDIC has rule-writing authority to define unfair and deceptive practices under the FTC Act. Is that going to limit your ability to protect consumers?

Ms. BAIR. Well, we enforce UDAP, but we don't have the ability to write rules. And so because there are no rules, we are finding out we have to use case-by-case determinations and consult a great deal with the Fed and the FTC about what is unfair or deceptive because we don't have the ability to define these terms.

Rule-writing authority would be extremely helpful, especially in the subprime area. If you have a rule, you can have a preventive effect. You can let the industry know as a whole that certain types of practices are going to be viewed as unfair and deceptive, as opposed to having to go in bank-by-bank in the supervisory process. Also, if you take informal action, it is not public, so there is not any precedential impact.

It will certainly be used in consultation and coordination with the other regulators, and I do think it would be helpful.

Mr. DUGAN. And I would just add that I agree with that. For many years it was not clear that banking agencies could even take enforcement action under unfair and deceptive. The OCC was the first agency to go down that path. We have taken a number of en-

forcement actions on a case-by-case basis, but we do think it would be helpful to have rule-writing authority.

Frankly, I think it would be most helpful to have it on a joint basis. Our concern is that if one agency adopts a rule, people could use other charters to do the same activity, although I agree with my colleague that as a practical matter we would probably work together in any event. But I do think that is important.

Mr. BACHUS. Could I ask one other question? Have any of the regulators or the FDIC found any credit card practices to be unfair or deceptive? Let me highlight three or four. One is that they apply your payment to your lowest interest rate. Another one is universal default where they increase your interest rate simply because your credit score goes up, or you approach your credit limit, or you take out a loan to buy an automobile, or a double-billing cycle, or a short billing cycle.

Even I now face a situation where you are up here all week, and sometimes you get home, and you have about 8 days or 6 days to get that check in the mail. And the cycle continues to shorten, it appears. And they also—as the chairman documented, many times they will—even though the payment arrives on a certain day, it is posted, but it is not credited until the next day.

Mr. DUGAN. We regulate a number of the credit card banks in the country. We have taken a number of enforcement actions against credit card banks for unfair and deceptive practices, primarily subprime credit card practices, and as a result there are very few subprime credit card providers left in the national banking system.

Having said that, the types of practices you described, double-cycle billing, universal default, those are not things that we have taken or regarded as unfair and deceptive so long as they are adequately disclosed. The regime that we have always operated under as a statutory matter is that fees and charges are not things that we generally regulate unless they rise to the level of being something that is unfair and deceptive the way that is defined in the Federal Trade Commission Act. And if those fees are adequately disclosed, they have not been treated as unfair or deceptive, and I don't know of any regulator that has treated them that way.

Ms. BAIR. I think those practices are highly troubling, but even assuming we thought they were unfair or deceptive, we would not have the ability to write a rulemaking that determination, whereas, we can write rules on safety and soundness.

I think previously you mentioned that universal default, in effect, is piling onto a person who has problems already. Perhaps you could make a safety and soundness argument to issue a rule to address the problem of universal default.

However, since we only have 15 percent of the credit card market, even if we could find authority under safety and soundness to write a rule, we would be imposing a rule only on FDIC-supervised credit card issuers that would not apply to banks not supervised by the FDIC.

The CHAIRMAN. And you would pretty soon have 1.5 percent of the market and not 15 percent if you had rules and he did not.

The gentlewoman from New York.

Mr. BACHUS. The Chairman of the FTC was trying to—

The CHAIRMAN. I am sorry. Please, Madam Chairwoman.

Ms. MAJORAS. I was going to add one thing. At the FTC, we don't have jurisdiction over very many credit card issuers because so many of them are banks, but where they haven't been, we have brought cases under deception and unfairness authority. And we do have a rule that prohibits advance-fee credit card and loan schemes. A lot of these are out-and-out scams, which is where we specialize. But I would point out that is one of the places where we do have a rule, but most of the time we use our deception and unfairness authority without any rules. We just use it in our enforcements.

The CHAIRMAN. I was glad you mentioned gift cards. That is an issue where in Massachusetts we went after where you gave a gift, and pretty soon it was you gave a gift that kept on shrinking, and you did not know that. By the time the person cashed the gift card, you looked like Uncle Cheapskate because it was half of what it was supposed to be.

I congratulate the Comptroller—I think it was the Comptroller's predecessor. There was an effort by the issuing banks who were shilling for the merchants there to invoke the preemption, and the OCC did not go along with that. So we were able to preserve, I believe, State authority there. But I appreciate you bringing it out. That is the prime example of the kind of protection we want to give.

The gentlewoman from New York.

Mrs. MALONEY. Thank you, Mr. Chairman. I was impressed with the list of reforms Chairwoman Bair proposed for Congress. And I would like to ask the other panelists about some of them, particularly the Honorable Kroszner and Honorable Dugan. What do you think of giving the States a greater enforcement role under truth and lending and the FTC Act against nonbank financial providers? And also the FTC?

Mr. DUGAN. I think it is a good idea myself. You might say it is easier for me to say because you are not saying it is providing it against national banks. But I do think that what recent history has shown is that the less regulated institution—and here I am not talking about State banks, I am talking about State-chartered institutions that are not regulated, like mortgage brokers or mortgage lenders—have been a significant source of the problem, and I think finding a way to devote more resources to addressing that issue is a good thing.

Mrs. MALONEY. Mr. Kroszner.

Mr. KROSZNER. I certainly agree it is very important to devote resources to protect consumers, and there are many things that are outside the scope of what the Federal Reserve can do in terms of enforcement, and so we very much rely on and coordinate with the States both for the institution—certainly for the institutions that we regulate, the State member banks. We coordinate very much with the States on those institutions. But there are many institutions, as Comptroller Dugan mentioned, that are outside of our purview for enforcement, and so providing appropriate resources to make sure that the laws are enforced to protect consumers is very important.

Mrs. MALONEY. And Chairman Majoras?

Ms. MAJORAS. There is no question in my mind or anyone at the FTC about the States' importance in enforcing consumer protection laws in this country. We work with them all the time, and we are a relatively small agency, and if we did not have them working side by side with us, we would do a lot less. So I will start by saying that.

The FTC has always taken the position that the States don't need authority under the FTC Act because—Tom could probably say it better—if not all of them, almost all of them have what we call little FTC Acts; in other words, they have passed their own statute that essentially mocks the FTC Act. And so we have previously said we don't think it is necessary.

We file cases as co-plaintiffs or in big law enforcement sweeps where we announce cases on the same day all the time, and it has not inhibited us. The thing to remember is that if you have too many regulators all enforcing the same statute, you can end up with some inconsistency. And what the States have typically done is look to Federal case law under the FTC Act, and that has kept us all, I think, marching in the same direction.

Mrs. MALONEY. I am also concerned about this, and it has been touched upon. I am concerned about banks entering into agreements with unregulated third parties who want to issue subprime credit cards. And I know the FDIC has investigated some of these activities, and I would just like to know, or to get a sense of, how big is the rent-a-charter problem? And is there a role for the States in this area? And how can Congress help? Maybe start with the FDIC and the OCC and the Fed.

Mr. DUGAN. Well, as I said earlier, we had a number of significant problems both on the safety and soundness and the consumer protection side with subprime credit card practices. We took a number of quite strong enforcement actions, and as a result of that whole series of actions that we took over a period of years, there just are not many subprime credit card lenders in the national banking system anymore.

Ms. BAIR. We carefully scrutinize these arrangements because they are prone to abuse. We are conducting a joint investigation with the FTC right now concerning the so-called rent-a-bin arrangements. We have identified about 10. We, again, closely scrutinize them. I don't know if I can categorically say they are all problematic, but they are certainly prone to abuse, and we are carefully reviewing them.

Mr. KROSZNER. Fortunately, we do not have any banks that are engaged in this practice, so we haven't undertaken any actions because there are no banks doing this.

Mrs. MALONEY. Any other comments? And then my time has expired.

Mr. MILLER. This is our great nightmare, of course, the rent-a-charter situation, where there could be enormous bad actors using the shield of Federal preemption. I think by and large, so far, Federal agencies have been fairly vigilant about that issue, and they really need to be. That is probably the biggest nightmare that we are dealing with in the sort of set of circumstances we have been put in with the Watters case and related cases.

Mr. POLAKOFF. Congressman, I would offer from the OTS perspective that rent-a-charters are simply not acceptable, and if we find it, we stop it. And whether it is credit card, subprime credit card, payday lending, it makes no difference. It is not an acceptable practice.

The CHAIRMAN. The gentleman from Louisiana.

Mr. BAKER. Thank you, Mr. Chairman.

I am appreciative of the fact that there has not been insurmountable attention given to the preemption issue, but rather where do we go now, in light of the definitive decision in the Watters case?

Mr. Dugan, in your testimony you recite the observation that the FTC Act vests with the Federal Reserve the ability to regulate unfair or deceptive practices at banks—comparable authority is invested with the OTS for thrifts, and the NCUA for credit unions. And so you establish that Congress has acted with regard to each specific financial sector to provide consumer advocacy responsibilities, but you go on to suggest that a unified working group of sorts that could provide for joint rulemaking opportunity would do great service towards the absence of venue shopping and having as best we can an equitable enforcement practice.

I would like to suggest and seek your counsel. Would it not be advisable, in light of the comments made by those representing State interests here today, that a representative of the CSBS at least in an advisory capacity, because it may not be proper for them to be voting on national bank regulation, but perhaps they would have perspectives of value, as well as, of course, the FTC, to provide some sort of working group format? We have presidential working groups of regulators that come out with reports which are generally ignored, but we could have a consumer working group, as an example, solely focused on consumer advocacy, identifying practices inconsistent with sound fiscal policy, and leave it then to each specific regulator to act consistent with others.

If we were to suggest something of that sort, that would not necessarily in itself require congressional action if agencies chose to work in such a cooperative manner, quarterly, semiannually, annually, even if it were just to report to Congress and say here is what we should do and let us evaluate that policy, if that is what you deem to be most appropriate.

From what I am hearing from everything is can't we share information? Can't we work together? No one has the resources to do this all on their own. Everybody can see problems. You might see a problem across the fence that is not in your jurisdiction, and if we got everybody together and had a more uniform system of consumer advocacy rules, the market wins and the consumers win. Is that an inappropriate observation?

Mr. DUGAN. Not at all. I think it is actually a quite good observation. I think recently in the last Congress, the State representative was added to the Federal Financial Institution Examination Council, FFIEC as we call it, and that would be a place to share that kind of information.

I think if you go beyond that to rule writing, which is one of the things you talked about, I think you did hit on one of the issues that would be involved as a constitutional matter and appoint-

ments matter. It is quite murky if you have a State official voting on something—

Mr. BAKER. Let me be clear. I meant only in an advisory capacity. They would certainly not want you voting on their rules. But I think the pressure would be if there was an identified problem by this group, and generally action were taken, that those aberrant players who did not subsequently act to protect their consumers would have immense political responsibility for their failure to act in light of the public discussion.

Let me also suggest that, given restricted resources, multiple 1–800s and multiple Web pages—I note on page 23 of your testimony that you will have up this summer your own Web page, which is helpmewithmybank.gov. So, you can log on and find out what you need to know and then move to the appropriate regulator.

It might also be appropriate for this group to think about consolidating those informational resources, because with everybody having its own Web page and 1–800, that gets to be confusing, and if there would be a way to consolidate that where you ultimately end up with a real person who lives in the United States and can speak in the language with which you are calling—I know that yours will be bilingual, I think that is appropriate—you would end up with something of value instead of having disparate standards which confuse consumers, and they don't understand exactly with whom they should make their complaints. This would be something that you guys could perform, I think, a significant service and perhaps break through this idea that you don't care about consumers.

Mr. DUGAN. Mr. Baker, I totally agree. It is one of the things that I talk about a little bit in my testimony. As you heard today, we are all doing different things, and you wonder if there is a way that we can coordinate and—

Mr. BAKER. What gets this started? Do we have to do it, or can you do it?

Mr. DUGAN. No, I think we can do this. I think we can do this at the FFIEC, and we can also invite our colleague at the FTC to participate as well. But that is one of the things that I haven't discussed yet with my colleagues, but I think it is something that we could do if people were amenable to it, and I certainly am.

Mr. BAKER. Mr. Chairman, I hope you will encourage their participation in seeking out a negotiated settlement on this. I take "yes" for an answer and yield back.

The CHAIRMAN. The gentleman from New York.

Mr. ACKERMAN. Thank you, Mr. Chairman.

Last week one of our subcommittees held a hearing that focused on some of the more disingenuous practices within the credit card industry, and some of our witnesses and Members made the comment that the Congress has not given the Federal Reserve enough regulatory authority to sufficiently restrict some of the egregious practices. Some of them we have talked about were universal default and double-cycle billing and pay-to-pay fees.

The question that I would like to ask first is, does the Federal Reserve feel, Governor Kroszner, that these are practices that require some type of restriction? In general, would the American people be better served if the Federal Reserve were given increased authorities to regulate the credit card industry?

Mr. KROSZNER. Thank you very much.

Certainly we take our responsibilities with respect to credit cards quite seriously. As you know, in the hearing last week we discussed a number of the new proposals that we put out to deal with these issues because we think they are very, very important issues.

The approach that we have so far taken is primarily through our regulation Z, TILA, Truth in Lending Act, authorities through trying to improve disclosure. I think it is true, as one of the other Members had said earlier, that the current disclosures are not adequate for consumers to understand what is going on, and that is why we have really focused on consumer testing to ask real people real questions about what do they understand, what can they get out of the forms that they are seeing? And we went back and forth quite a few times to improve the information that is out there, not only the accuracy of the information, but the understandability, the usefulness to individuals.

I believe that we have—we believe that we have sufficient authority to deal with these issues as of today; however, we are continuing to take actions to look further into what needs to be done in this area and a number of other areas, and certainly we will not hesitate to come back to Congress to ask for further authority if we need to.

Mr. ACKERMAN. Thank you. I appreciate that.

I have a second concern. I get these letters in the mail all the time, besides the credit card ones, again with mortgages, and I get a lot of them. Sometimes they are very official-looking, and I am sure that is not by accident. And they are designed to make it look like it is from the Federal Government or sometimes the State government or sometimes some unknown great official authority. And it is very, very misleading.

This one does not identify who it is from on the cover. This one is a similar design. It happened to come from the same source, I believe. And it says right on the front, Re: Your current loan with Citibank North America—which is one of the mortgages that I have a property—Request for immediate action. I think this is from my bank when I get it. Most people would think that because it is up there in the return address area. But it is not.

And there are all sorts of warnings on here that are postal regulations that everybody knows about. You don't have to put it on the envelope, but you do if you want to make it look official: Warning, a $2,000 fine and 5 years imprisonment for anyone interfering with or obstructing the delivery of this letter. This is an important letter. There are all sorts of codes, and then it says, your mortgage recorded in the county of, and there is all sorts of stuff that actually I once had. I guess they did not know that I paid that one off and already switched it to somebody.

And it goes on looking real official-like. And then there is a big notice on this part of the page: Notice, the Queens County property code in Jamaica, New York, notification date. Recent changes in our mortgage policy. There are programs now available to Queens County residents.

Now, I would think this is some kind of government program if I was an average person or somebody who is not reading this carefully because they don't have the time, but gets an impression and

all sorts of things. And they give you—I can get this deal for a rate of 1.25 percent. Now, if I am a senior citizen on a fixed income, and I think I had an interest rate that I am paying now of 6 or 7 or 8 percent or something, and I am going to be able to pay 1 percent, I don't realize that they could eventually take my house, or I am going to owe more on the mortgage than the house is worth, but they don't care because that is not going to be 1.25 percent for too long.

I get this one that does not have any return address on the front, nothing on the back, and it says, "Certificate enclosed." That is all it says besides my address. And it comes looking like this. That certificate of finance, preferred, bearer's certificate, made out to me. This looks so official with big "equal employment" thing on there and FHA things and certificate numbers and guys, you know, half dressed, carrying shields and swords, and things looking like they came from dollar bills printed in the color of ink. You have to read it 10 times to find out that it is not from my bank, but somebody that wants to snipe my mortgage.

Is this fair? Should the industry not be policing itself, or should some greater authority be supervising what is going on here?

Mr. MILLER. Congressman, that is deceptive, deceptive in so many ways, and it is a violation of Federal laws and a violation of State law, depending on preemption, of course, and that is the kind of thing that we all should be after.

Mr. ACKERMAN. Are we after it, though? What is being done?

Mr. ANTONAKES. I would add in Massachusetts last year we passed a law prohibiting those very types of deceptive advertisements featuring the third-party use of a bank name. And we have taken enforcement actions against entities that we license and referred others that use these types of advertisement. I would also just add quickly that we will enforce that law whether the complaint is against a State-chartered bank or a national bank.

Mr. ACKERMAN. I always liked Massachusetts. I hope the chairman makes a note of that.

Shouldn't there be a Federal role in this?

Mr. POLAKOFF. I would like to offer that I suspect that did not come from an insured financial institution. I suspect it came from a mortgage bank or a mortgage broker, and I think that is where the emphasis should be focused.

Mr. ANTONAKES. I would not disagree. They generally come from third parties. We would enforce the law whether the complaint was from a State bank or a national bank for the illegal third-party use of their name, and it has also come from insurance companies, as well.

Ms. MAJORAS. Briefly, Congressman, the FTC has enforced against a number of nonbank mortgage lenders that have made deceptive representations to consumers, whether it is about interest rates or fees and the like. We have done that.

Now, just, you know, what it says on the envelope, that by itself, to be honest is not the only story, because we can also bring cases when consumers are truly harmed by it. But if you go inside, and it is telling you that you can get a mortgage at a particular percentage and can't and so forth, that we have taken very seriously.

The CHAIRMAN. Let me ask, we get letters like this all the time. How can they send that to me? If I got a letter that like that, and I wanted to refer my constituent to a place where he or she might be able to get enforcement action, which of your agencies should we refer that to? In Massachusetts, it would be you.

Mr. ANTONAKES. Absolutely.

Mr. MILLER. Our office too, or State attorney general's office. But there is maybe a larger point here.

The CHAIRMAN. Let me ask first, would any of the Federal agencies—I think that is what the gentleman was getting at. I wouldn't want his dramatic reading to not get its full impact here. Would any of the—

Mr. ACKERMAN. I appreciate the rescue.

The CHAIRMAN. Would any of the Federal agencies be responsive if we were to say, look, what is going on? What can you do about it?

Ms. MAJORAS. We do get these things all the time at the FTC, and we look at them. And incidentally, since we have been talking about complaint filing, too, we get probably 15,000 complaints a year that would involve actual banks or other depository institutions.

The CHAIRMAN. I would assume, for the three bank regulators, if it did not come from a regulated financial institution, you have no jurisdiction. It would be the FDIC.

Ms. BAIR. This is right. I am sure this letter did not come from an insured institution. I see this all the time. I get these at home. I get the spam faxes. That is one of the reasons we are urging that State authorities, the attorneys general, and the Federal supervisors at the State level, be given the authority to supplement what the FTC already does to go after the entities that are conducting this type of marketing.

Also we very much work with the Federal agencies with the hope of rulemaking to expressly say, we think that this is unfair and deceptive. I don't have the power to write the rule, but the Fed does, to say specifically that this type of advertising is unfair and deceptive.

The CHAIRMAN. Would the Fed have the right to write that rule covering both depository institutions and others?

Ms. BAIR. Yes, for the extension of mortgage credit they would.

The CHAIRMAN. The gentlewoman from Minnesota.

Mrs. BACHMANN. I have a question for the Comptroller, Mr. Dugan.

Mr. Dugan, I understand that the OCC has entered into some agreements with the States related to the identification and enforcement of State laws, and I was just wondering if you could describe for me some of those agreements?

Mr. DUGAN. I think the agreements I was talking about earlier are the agreements for information sharing about complaints. So if we get a complaint filed that really belongs with the States, much like we were just talking about, we would have a way to get that to the State efficiently, and vice versa, and if the State got a complaint that related to a national bank that we needed to take care of, there would be an efficient process not only for us to get it, but

for us to share information about what we did with it with respect to a consumer in that State.

And so we entered into a model type of agreement with the Conference of State Bank Supervisors, and then individually have been contacting States to try to get them to enter into agreements so we could do it as a practical matter, and since December, we have 18 States that have agreed to do that.

Mrs. BACHMANN. Thank you. Do the State anti-discrimination laws apply to the national banks?

Mr. DUGAN. State anti-discrimination laws do apply to national banks by long-standing legal precedent.

Mrs. BACHMANN. How about the State unfair and deceptive practices laws, do they apply to the national banks?

Mr. DUGAN. They do if the way they are applied or the way they are ordered don't actually put in specific requirements that regulate, or attempt to regulate, the particular banking activities of a bank. So if it is a general unfair and deceptive act, what we were talking about earlier, the little FTC acts, those on its face are not preempted, we would say.

Mrs. BACHMANN. What consumer protection laws do not apply to national banks?

Mr. DUGAN. Well, this is an issue of course that has come up and people have been talking about it recently, and it is something that the GAO looked at as well. We have pledged to talk with the States about how we look at which laws we believe are not preempted, and which ones are. Frankly, a lot of that got put on hold because of the Watters case and the outcome of it. Now that it is over, we do recognize that we need to get more clarity on that. We already have addressed this in significant ways in our regulations and what we have put out, but we need to provide more.

I think, as GAO recognized, it is not a situation where it is practical to go to each State and go through the code and identify every single one that is or is not preempted. So there will be principles that we will be articulating in outreach meetings as we committed to do.

Mrs. BACHMANN. Mr. Dugan, could you tell the committee, how does the OCC's regulation compare with the rules that were adopted by OTS and NCUA?

Mr. DUGAN. To have such a specific comparison, I would love to be able to get back to you for the record on that. I know what ours does, but I can't give you chapter and verse on exactly what theirs do. But I would be happy to respond for the record if that would be appropriate.

Mrs. BACHMANN. That would be fine. We have an example of one of the State attorneys general investigating student lending, and that suggests that State attorneys general are playing a very important role in consumer protection. I wonder if you could tell the committee what would be the impact on the national banking system if State attorneys general which bring enforcement actions against national banks.

Mr. DUGAN. Well, I think this is the same question, whether it is student lending or other issues that the Supreme Court had to address, which is what is the legislative scheme that Congress has adopted with national banks. And it has always been our view that

historically the idea has been to have a uniform set of Federal laws that apply to the national banks wherever they operate, or whatever part of the country that they are in. And that is what the Watters case upheld, that if national banks are exercising their banking powers, whether at the bank level or at a subsidiary level, it is a set of uniform rules that applies. And so in those circumstances, State laws would be preempted.

We believe we have robust ways, as I have tried to outline in our statement, to address the consumer protection issues that we have been charged with addressing, and that regime is established by Congress, by you, and can be expanded or contracted. And we will faithfully implement those laws, but do so in a uniform way throughout the country.

Mr. MILLER. If I could jump in, I think your question was what effect would happen if the State AGs enforced the laws, not what the law is. The effect, I think, would be great. It would be consistent with our Federal system. The State AGs have stepped forward and done some innovative things in the securities area, insurance with Eliot Spitzer, now in the predatory lending area, as well as in student loans, and the country is better off for that. Those laws in various forms weren't being enforced. The AG stepped forward and protected the public and pursued the public interest, and we are all better off for it. And it is consistent with our Constitution, consistent with the great wisdom of our Founding Fathers concerning checks and balances and federalism. It is an incredible system that at least in my view is now frustrated by the recent practices of the OCC and the Supreme Court decision.

Mrs. BACHMANN. Attorney General, thank you for your comments. I wonder, could you also tell me what resources you have to examine national banks and Federal thrifts for compliance with State law?

Mr. MILLER. We don't, and shouldn't have, resources to examine them for safety and soundness. We never suppose that we should do that nor should our colleagues, the banking superintendents, and they don't. But we have enormous resources in the consumer protection area. That is one of the bread and butter of many of our offices. And we bring those and used to bring those resources to the national banks in an effective creative way. I think there was one estimate in terms of consumer protection, the States bring 17 times the resources of the Federal agencies that are here today in terms of consumer protection.

Mrs. BACHMANN. I have a question.

The CHAIRMAN. We are over time.

Mrs. BACHMANN. Thank you, Mr. Chairman.

The CHAIRMAN. I thank the gentlewoman for those questions.

Mr. Kroszner, I am going to ask you a question, but as we proceed I am going to make a statement with regard to your rulemaking authority: use it or lose it. I was struck by the agreement. The Comptroller and the Chair of the FDIC didn't agree on everything. It does seem that both are in a position of being criticized because you did not roll out the rules which they can use. I don't think case-by-case does it. I don't think case-by-case in complex situations like we live in is a good idea. And I think I speak here probably for the majority of this committee. If the Fed doesn't start

to use that authority to roll out the rules, then we will give it to somebody who will use it. You reinforce my sense that the Fed is not the best place to do consumer protection. And all of our legal traditions about people knowing what they are doing, etc., having some due process, that is important.

It is also the case, it seems to me, that we don't want to stop people doing bad things after the fact: we want to deter people from doing bad things. If you are in a case-by-case situation you are greatly constrained against penalizing people. It is one thing to penalize people who have violated rules. It is another to tell people to stop doing something case-by-case where they can legitimately say, well, I didn't know that. And without rules that would be the case.

So I think the rulemaking authority is important. Now, there is a—again, I would rather see the OCC and the FDIC, and I assume the OTS would agree on this, but the rulemaking decision should be joint. And obviously, it is better to have one set of rules. If the Fed is willing to work with them to do it, that is fine. But I will tell you if we need to begin to see the process of rulemaking going into effect for this area. And the answer is that it is especially true now with the preemption. Their workload, what they have to do with regard to consumer protection, has clearly increased as a result of the most recent decision about preemption, so I think this just has to happen.

Now, the next two questions. We have—yes, Mr. Kroszner.

Mr. KROSZNER. If I might just very briefly respond. We really do take the consumer protection area very, very seriously. We have an entire division—this gets back to an earlier point that you made about monetary policy versus consumer protection. We have a division of monetary affairs but we also have a division of consumer community affairs at the Federal Reserve board, and we have similar divisions at all the regional Federal Reserve banks, and so we do have it at the highest level.

The CHAIRMAN. I don't think it is what motivates people mostly. Certainly that wasn't the experience, it seemed to me, of Governor Gramlich. But there is also a philosophical distinction. You say specifically in your testimony that the Fed doesn't think it should use the rulemaking authority. I believe overwhelmingly this Congress will think that it should. And I want to put you on notice that it is not a personal thing, but there is a real difference. And I believe, particularly now that the role of the Federal regulators has increased, there has to be a change in the rulemaking authority. It can be done jointly, but it I think has to be done. And I think the absence of rules is a serious problem that needs to be dealt with.

For example, the Comptroller said with regard to the practices like these that credit card companies engage in that make a lot of people angry, justifiably, essentially as long as they are explicit about what they plan to do, they can do almost anything. Maybe that is the current state of the law. I will tell you that I think there are some things that are so counterintuitive to individuals that if you nailed it to their foreheads, they still wouldn't fully understand it. There are some things that consumers think, well, that can't be. And I will say for the credit card issuers, no, we don't want fixed rates. But there is an intermediate position between rate setting

and simply telling people—let me put it this way in effect—maybe I will have to clear up the record later. We are your credit card company. By the way, here on page 7, it says that we may screw you from time to time and by signing this application you have waived any objection to that? That is notification, but it is not going to be enough.

But two other questions specifically. One, we have unregulated entities, it has been noted in response to Mr. Ackerman's question. We need at a Federal level, I believe, to pass some laws to cover currently unregulated entities. I think that is right. If only the entities that the banks regulated issued subprime loans, we would not now be in a crisis. The banks are entitled to have us acknowledge that. There are entities that make these loans that do other things that are not now regulated. I think there needs to be a national law. Exactly how it fits with State law, to what extent it is preemptive, we will work that out. But it does seem to me that there needs to be a national law if only to keep institutions from leaving a State that has strong laws to go to places that don't.

What I would want from you, and it doesn't have to be today, is a sense of who should be that regulator? It is one thing to create the rules. We are going to have to create some new rules, I believe, about subprime. And we are talking about unregulated institutions, nondepository institutions. Do one of you want to take that over? I am serious. Or does it go to the FTC or does it go to HUD? We are not going to adequately be able to regulate that unless we create a regulator. I would ask your advice in writing about that.

The other issue is on the States. I will say that I agree with much of what you said, but when you talked about your concern for the overstressed State resources, to be honest, that did not strike me as your primary motivation. When you say, oh, you don't want the States involved in this thing because you have such sympathy with these poor overstressed State regulators, well, we will worry about them. I appreciate your compassion in this case, but it does not seem to me that was your primary motive. I think the States have the resources.

Let me ask you about one specific issue. One entity that has been very much active in State regulation is the attorney general in each State; that is why Mr. Miller is here. You don't have any comparable Federal authority, for example, Ms. Bair doesn't have any comparable authority. You have the Justice Department, but it is not the same. The ability to bring injunctive lawsuits, the ability maybe even to get punitive damages in abusive cases, but you have to have rules before you can do that. Are you not somewhat handicapped vis-a-vis the States? And I would say this to the Federal regulators. Mr. Antonakes can go to the attorney general of Massachusetts. In the absence of that kind of legal enforcement, to the extent that we transfer from the State regime where the supervisors and the attorneys general work closely together to a national regime with an attorney general, how is that not a diminution to some extent of the force with which we can apply these protections?

Mr. DUGAN. Actually, Mr. Chairman, I think we have more authority with respect to the banks that we regulate. We don't have to go to a separate agency to get a bank to stop immediately doing something that we find that violates the law. We have extraor-

dinary powers under the Federal Deposit Insurance Act to take formal enforcement action. Long before you get there, we have the power to get—

The CHAIRMAN. You never want to go to court, or you do?

Mr. DUGAN. It is actually quite rare that we go to court because institutions almost always settle because of the great power that we have as a formal enforcement matter. That is a reality.

The CHAIRMAN. The other point I want to make is, you talked about matters requiring attention and how many of you deal with them. You say that many of them are consumer related. I will close with this: I guess we are talking about things being unfair and deceptive. I want to get disjunctive. I think we need to make sure we get things that are unfair or deceptive. A regime in which deception has to be there does not protect consumers. There are unfair practices that are not technically deceptive. And I guess that is the sense. You got it from my colleague, the ranking member, and others. We do not think you now are adequately dealing with practices which are unfair, probably because you don't have the authority. You may need the statutory authority. You may need the rulemaking. This is not a personal failing on the part of any of you. But I guess that is what I would leave you with. In today's world, with the banks so creatively making money off fees, off overdraft fees—I mean, I think that there are people who watch their congressional calendar, and they see when I get a vote on Friday, so they mail my credit card bill because then I will be a day late getting back to it. There are so many of these other practices that are not deceptive, but I believe they are unfair.

So I will close with this. Somebody is going to have to do some rulemaking and you are going to have to go beyond deceptive into unfairness. We are not talking about rate setting, we are not trying to put anybody out of business, but I think you have a broad consensus to do that.

Mr. DUGAN. I will defer to my colleague after this from the FTC because they actually have the authority. I think we need to be careful here, if unfair or deceptive, but the unfair standard legally under the Federal Trade Commission Act is not a judgment about unfairness.

The CHAIRMAN. I understand that, but you are not here arguing as a lawyer before the Federal Trade Commission. We will rewrite the Federal Trade Commission Act with Mr. Dingell's cooperation. So understand, we are not now into statutory interpretation, we are into statute writing. And what I can tell you is, and it may be that you don't have enough statutory authority, but we have to give you a broader reach to go after things that are in the perception of the people in this country unfair. And if the problem is lack of statutory authority, then it is our job to care about that.

Ms. BAIR. I would just say that there can be a restrictive legal standard. If you are looking at the statutory language in this area, you might consider adding the term "abusive." "Abusive" is a standard that is contained in HOEPA that the Fed is looking at using in the context of mortgage lending. But "abusive" is a more flexible standard to address some of the practices that make us all uncomfortable.

Ms. MAJORAS. I just wanted to clarify that, in fact, the FTC Act allows us to attack practices that are unfair or deceptive, and we do. And we have brought plenty of cases that attack unfair practices. But it was Congress that went back to the FTC at one point and said you need to define what unfairness means, because of course Congress didn't want it to mean just whatever, whoever happens to be sitting in my seat thinks it means. So there is a standard.

The CHAIRMAN. I appreciate that. When was that?

Ms. MAJORAS. I think it was in the 1980's.

The CHAIRMAN. In the interim, a lot of my good friends work for financial institutions and they play an essential role in this country and I am grateful to them and I work with them, but they have succeeded in angering a significantly large part of the American people by nickel-and-diming them on credit card late fees and overdraft fees. And I think you are going to find a Congress today that is less inclined to restrain you and more inclined to encourage you to reach out and give consumer protection.

Mr. CAMPBELL. Thank you, Mr. Chairman. I just have a few questions for Mr. Dugan here. The first concerns subprime. My understanding is that over 90 percent of the subprime loans are not originated in banking institutions that are supervised.

Mr. DUGAN. In national banks last year, that is right.

Mr. CAMPBELL. In national banks, okay, last year, great. Given that statistic, is this an area where a national rule makes more sense than a State-by-State if over 90 percent of the loans are not?

Mr. DUGAN. It is certainly true that because we have such a small part of that market, and because we haven't frankly had the same kinds of problems with the banks that we regulate that engage in these activities, you do need broader coverage. But that is exactly why the bank regulators have gotten together and proposed guidance that applies to all, not only insured institutions, but companies affiliated with them, which we are about to finalize, and, getting to your point, we have enlisted the Conference of State Bank Supervisors to get their agreement to try to get that same guidance out to the State lenders that none of the Federal regulators touch.

So do I think that there needs to be some kind of national standard? The answer is yes, because so much of this market comes through the States. It can be done by each of the Federal regulators and each of the State regulators, which is one approach. Another that has been talked about is the Federal Reserve addressing some of these issues through their rule writing authority. And failing that, the last line would be actual legislation. But it is absolutely imperative that we have some kind of nationwide approach to this problem.

Mr. CAMPBELL. Just to understand that answer better, that order you gave is the order that you believe is preferable?

Mr. DUGAN. I guess I would say, one, we can do now and are in the process of doing and working down that path. I think the second is an area where the Federal Reserve, and Governor Kroszner, of course, can speak for themselves. But they are holding a hearing tomorrow to talk about it. And I just think as a matter of time,

precedent and so forth, getting to Congress is a third practical reality.

Mr. CAMPBELL. Another question along the same lines, but not just subprime—a lender in one State can make loans to people in any State. So does that make, if you are looking at consumer protection, does that make some kind of uniform consumer protection a better approach?

Mr. DUGAN. I think there are certain practices that have become national products, commodities if you like, and they raise the same issues over and over again. And those are the ones that I believe cry or call out more for national kinds of standards. Because as you say, things can happen in different States.

Mr. CAMPBELL. And the third question, I think you kind of touched on in discussing things with the chairman a little, but just maybe you can elaborate on preemption by you guys. We have talked a lot about resources relative to State license mortgage lenders, resources at the State level versus preemption by you guys. It sounds like you believe that looking for more resources or more involvement at the State level is something preferable to preemption by you guys.

Mr. DUGAN. I guess what I would say is that I think we do have adequate resources to put in place a standard. Let me give you an example. One of the things that I have spoken about recently is the use of stated income or totally undocumented income in order to make loans. It is something that we will address, I think forcefully, in the guidance we are about to issue to make that no longer the general rule when you do a subprime loan. If we adopt that guidance, we would be able to implement that guidance in national banks around the country wherever they are situated to have that as a standard. There is no similar mechanism to make sure it gets done in the same way in the more than half of the market that Federal regulators don't touch. The States individually are going to do that. But if they are not actually in those institutions supervising them, it will take a longer time to do it. That is really what I am getting at. If you have a finite amount of resources, rather than devote them all to the really heavily regulated insured institutions, doesn't it make more sense to devote them to the States? We do the national banks, hold us accountable, but that it is a better division of labor in order to achieve the maximum benefit for the consumer.

Mr. CAMPBELL. Okay. I yield back. Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from Missouri.

Mr. CLAY. Thank you, Mr. Chairman. Thank you for this hearing. I certainly will attempt to observe the 5-minute rule. I have a set of questions for the entire panel. Recently I was reading an article entitled, "Unsafe At Any Rate," written by Elizabeth Warren, and I want to use that analogy that she used. It is impossible to buy a toaster that has a one in five chance of bursting into flames and burning down your house. But it is possible to refinance an existing home with a mortgage that has the same one in five chance of putting the family out on the street and the mortgage won't even carry a disclosure of that fact to the homeowner. Similarly, it is impossible to change the price on a toaster once it has been purchased. But long after the papers have been signed, it is

possible to triple the price of the credit used to finance the purchase of that appliance, even if the customer meets all the credit terms in full and on time.

The question is this. And Ms. Warren suggested that perhaps we create a financial services product safety commission. Should there be more Federal regulation? Why are consumers safe when they purchase tangible consumer products with cash, but when they sign up for a routine financial practice like mortgages and credit cards, they are left at the mercy of their creditors? The answer given by the author is regulation.

I ask, where are we dropping the ball? What is your answer to this problem, and where do we go from here? If we could start with Mr. Kroszner, please.

Mr. KROSZNER. Thank you very much. It is certainly extremely important in all areas to protect consumers, whether it is health and safety regulation, or their financial well-being. So these are both very important issues. I do think there is a bit of a distinction between something like a toaster and some financial products. I think it is very easy to objectively define whether a toaster is likely to burst into flames. With respect to financial products, some things that could be helpful and useful to certain types of customers may not be helpful and useful to other types of customers. I think with respect to a toaster bursting into flames, it is very clear that one bursting into flames with a one in five chance, that is harmful no matter who you are, and no matter where you are. With respect to financial products it becomes a little trickier, because certain types of products which may not be appropriate to some people may be appropriate for other people. So it is much more difficult, I think, to set up those types of bright line distinctions.

That said, it is very important to make sure that if there are certain types of practices that are inappropriate, that we address those, and that is one of the reasons why with respect to mortgages we are holding the hearing tomorrow on HOEPA to look to see whether there are sort of certain systematic patterns and practices that we need to address.

Mr. MILLER. Congressman, I said earlier that if the seven of us at this table really meant it, and worked together, and used all of our power in the subprime market, and we all have power, including the States have significant power there, going forward, we could reform the industry. And I say that because of what has happened. Some of the bad companies are out of business, some of the better companies are still there. They have reputations to deal with. There has been pain for the people who have been foreclosed on, there has been pain for the investors. The time is right. If the seven of us and the people who work for us really work together cooperatively and spot the various problems and use our expertise, we could really clean up the industry.

There is one other thing that needs to be done, and that is that the current situation with all those foreclosures—there what has to happen is, with us and with everybody in the industry, they have to have what we call Iowa common sense. And that is to renegotiate some of the terms so that the consumer, the borrower, can make the payments and the creditor, the investor, is better off be-

cause they make more money that way than on foreclosing. We went through that in the farm crisis. I think more and more people are understanding that. The whole industry has to understand that, act on it, and that can ameliorate the current crisis considerably.

So we know what to do. The question is, will the seven of us do it.

Mr. CLAY. Mr. Miller, have the consumers been unexpectedly caught off guard as far as knowledge of these balloon payments?

Mr. MILLER. They have, they have. It is a scandal in the sense that the mortgages, particularly the subprime mortgages, are enormously complex. The people are very much at need. They are the working, the lower working class Americans, who don't have any margin for error. They have an economic situation, they need the loan, it is very complex. And in the past, there has been so much willingness on the part of certain players to abuse them, they have been taken advantage of, and it is a national scandal. And we can wring our hands about that, and we brought some lawsuits and that is good. But the big thing is, what do we do now? Do we solve the current problem and do we work together using our powers and using them aggressively where necessary, always reasonably, or do we all sort of splinter up, the seven of us up here?

Mr. CLAY. Thank you for your response. May I?

The CHAIRMAN. Yes, you can continue another couple of minutes.

Mr. CLAY. Ms. Bair.

Ms. BAIR. I have a lot of respect for Professor Warren. She serves on our Advisory Committee on Economic Inclusion. Although I haven't read the complete report yet, I am familiar with some of her thoughts on this. I agree with your analysis, but I am not sure that we need a new financial regulator. There are seven of us here on this panel. I think there are some ways that we can improve existing authorities and use them perhaps more proactively. In a coordinated fashion, I think we can take care of this problem without a new regulator.

Mr. CLAY. Thank you, ma'am.

Ms. MAJORAS. I would start with this, closure. There have been comments here about well, closure is not the whole answer. I understand that. But we released a study today that our economists have been working on for some time which shows that even consumers who are fairly educated, and think they understand the current mortgage disclosure forms, don't. Because when our people sat down and worked through it with them, they realized that there were costs and charges and they didn't have any idea what they are, so people don't know what this is costing them. We hope we can use this, and we developed some prototypes on what would work, what consumers would better understand. Because I do think it has to start with that. Ray is right in the sense that you have to be careful here because there are some bad things that happen, but there are people who did get credit and did get homes that are still paying for those homes who got them in the subprime market who wouldn't have gotten them in any other market. We have to remember that, too, because those people deserve to have a home as well.

Mr. CLAY. What is your opinion about the creation of a financial services product safety commission.

Ms. MAJORAS. I think I agree with my colleague Ms. Bair that I think we ought to try to work this out with what we have. There is no question that we all have different jurisdiction and so forth, but we all, in some piece, have the consumer protection aspect here. And we know where consumers are being harmed and so we ought to be able to attack it with what we have. And if we don't come through on that, then I wouldn't blame you for considering something else, but I think we should start with that.

Mr. CLAY. Yes, sir.

Mr. POLAKOFF. Congressman, there was a recently publicized supervisory action taken by OTS against the Federal Savings Bank for—we could characterize it as unfair or deceptive or aggressive underwriting to take advantage of borrowers. And when we pursued the action, we briefed the other Federal banking agency sitting at the table. And I am convinced if they would have seen a similar situation they would have taken equally aggressive supervisory action. So I believe when we find predatory practices, which is entirely different than lending to the subprime community, when we find it we take appropriate action and we communicate amongst ourselves to ensure that there is some sort of level or horizontal analysis.

Mr. CLAY. No matter who the perpetrator is?

Mr. POLAKOFF. If it is within our institutional jurisdiction, we will take action regardless of the perpetrator.

Mr. CLAY. Yes, sir.

Mr. ANTONAKES. Congressman, we license mortgage lenders and mortgage brokers in Massachusetts, and they are not unregulated. We conducted over 400 exams last year that resulted in over 100 enforcement actions, 3,700 enforcement actions by all the States combined against lenders and brokers collectively. We continue to do work here, we need to do more work here as well, and we need to work with our Federal counterparts. The idea brought up by Comptroller Dugan, to coordinate our examinations of lenders and brokers, is something I broached 3 months ago, because you can't look at broker network solely. Certainly sales and marketing practices of brokers are a concern that needs to be dealt with. But you also have to look at the internal controls and underwriting processes that took place at nonbank as well as bank subprime lenders. And then you also have to look at the funding structure and also what is going on in the secondary market as well. I think disclosure needs to be improved. We support the Federal Reserve using their broad rulemaking authority whereas we have attempted to deal with the issue with individual State predatory lending laws, including my own in Massachusetts, which has only been somewhat successful because not everyone complies with them. And then also in Massachusetts an attempt to deal—

The CHAIRMAN. You can finish the sentence.

Mr. ANTONAKES. I would just say trying to deal with the issue now, as well as in the future, we have set up a hotline where anyone who is having foreclosure problems can contact us. We feel that 400 calls in 6 weeks time, trying to refer them to reputable coun-

seling agencies and also work directly with their lenders and also mediations as well.

Mr. CLAY. I thank the chairman and the panel for the indulgence.

The CHAIRMAN. The gentleman from North Carolina.

Mr. MCHENRY. Thank you, Mr. Chairman. I am from North Carolina, and the North Carolina anti-predatory lending law that has been vaunted here in the halls of Congress is a wonderful thing that needs to be expanded to the national level, that somehow it had this fabulous effect in North Carolina. In the Sunday Charlotte Observer, they have a large expose that they are continuing, a long series about the fallouts and the foreclosure rate in North Carolina and that this vaunted anti-predatory lending law has actually had an adverse effect in the market. And it sort of brings to mind something, Mr. Dugan. There is this discussion here in Washington by consumer advocates that our Federal law isn't sufficient, that we are not doing enough to protect the public. Yet when we get into the details about bad lending practices, predatory lending practices, it seems that—well, it is apparent that this is not primarily an issue by federally regulated institutions. We have seen the main abuses occur through State regulated institutions. Is that a fair assessment?

Mr. DUGAN. I think it is a fair assessment, and I am not just saying that because I am a Federal regulator. I think, in a brief filed by the attorneys general, 46 out of the 50 attorneys general agreed that the real predatory lending practices were not taking place in regulated insured depository institutions or their subsidiaries. Those tend to be State chartered companies, some of which have some ties to Federal regulators, but many of which do not. And just last year, over 50 percent of subprime originations were in completely nonfederally regulated markets. Not all of those are bad loans, but some of the problems we have seen, and the more egregious ones I think, it is fair to say have been at those institutions.

Mr. MILLER. If I can just jump in here.

Mr. MCHENRY. If I may finish here. I only have a set amount of time.

Mr. MILLER. But you raise some issues directed towards us.

Mr. MCHENRY. I appreciate that, and thank you so much, but I will get to you in a second. I have a follow-up to him, and this is actually my time, respectfully, sir. But to continue that thought, would that indicate that we need to create another Federal law? Do we need to go further with our Federal law or is it kind of adequate? Should the focus be changing the State-by-State regulations of those State regulated institutions? Would that be a reasonable conclusion?

Mr. DUGAN. I think there are some things that occur in both markets in the subprime area, and that is why the Federal regulators got together, as we can do pretty quickly, to issue proposed guidance in that area. The question is, how do you get those same kinds of standards to apply to the exclusively State regulated entities. And that takes action by the States and CSBS has committed to go down a path of going State by State to do that. If that works, that may address the problem. If it does not, that is when people are considering other measures to get a national standard, whether

it is a regulation by the Federal Reserve, which has its own set of issues, or a congressional law.

But the first place that we are looking is guidance by the Federal regulators jointly to be with companion guidance to follow by the States. Of course the question is, you have to have uniform application in the States. It is not enough just to say you are going to do it, you have to do it. But that is the first place that we are looking.

Mr. MCHENRY. What is the Federal Reserve's perspective on this? I know they have taken some action.

Mr. KROSZNER. Well, it is certainly very important for us to coordinate with the States, and it is important for the States to have sufficient resources to be able to deal with the issues that they need to deal with with respect to institutions outside of the Federal regulatory purview. And so we try as much as possible to cooperate with them.

Exactly as Comptroller Dugan had said, in working up, for example, the nontraditional mortgage guidance that we issued last year, we have worked very closely with the States. We have even sent Federal Reserve staff members to testify before various State legislatures to try to convince the States that they should adopt the same types of guidance, same types of regulation. Some States are able to do that without legislation. And we have had, I think, a lot of cooperative success on nontraditional mortgage guidance, and we will be working exactly the same with the subprime mortgage guidance that should be coming out.

Mr. MCHENRY. My time has expired. And if I may just, Mr. Chairman, to Mr. Antonakes. There is this disparity between the amount of bank examiners and oversight that we have. And we have about 1,800 bank examiners for about 1,850 federally regulated financial institutions. There is a great disparity about the number of State regulated, State bank examiners versus the number of State banks. Do you think we have enough in the way there? And when he finishes up, Mr. Miller, if you want to chime in. You seem anxious to do that.

Mr. MILLER. I am waiting patiently, as long as I get my turn.

Mr. MCHENRY. Welcome to Congress. Mr. Antonakes.

Mr. ANTONAKES. I can speak for my State that we have adequate resources to fulfill our responsibilities, and I think it is up to the individual States to make sure in their own discussions with their administration and their legislatures that they have what they need to do the job. I would only add that we have been supportive of the process for the nontraditional guidance. I would suggest if that takes place within the confines of the FDIC where we can participate, it is a far better process. We don't have to wait for the Federal action to be done. We can do it in companion, in part of that actual process, and not be locked out of the actual rulemaking process.

Mr. MILLER. The chairman sort of gave the recommendation early not to have finger pointings on what happened, and it was a good recommendation that I followed so far. But there have been repeated statements that most of the loans came from State regulated places in the subprime area a number of times. And with some uniformity in questions from the minority side, although not Mr. Bachus, it has come up a number of times. So let me just say

this, that there is responsibility at the State and Federal level for the subprime crisis. National banks certainly had some involvement throughout the whole process, including in the securitization and in the purchasing of the loans. There is responsibility to go all the way around. The only thing I would point out is that Steve's agencies and the attorneys general were working very hard in this area and accomplished a significant amount of good despite what happened. We were much more active than our Federal counterparts, is what I would leave you with.

In terms of North Carolina, I would be interested in what the paper is saying on your statute. There have been other studies that show that your predatory lending statute has worked very well, that it hasn't dried up credit. And indeed the Ameriquest case, Ameriquest left North Carolina for an extended period of time as a result of that statute. And the abuse that they directed throughout the country was much less in North Carolina because of your statute.

The CHAIRMAN. The gentleman from North Carolina.

Mr. WATT. Thank you. To get the view from that side, and you get the view from this side of North Carolina, my assessment is much, much more similar to the one that Mr. Miller has outlined. And I don't think it does us any good to engage in this kind of activity, pointing at each other and casting blame here. My experience is that there is enough blame to go around for the subprime debacles at every level. And despite the fact that North Carolina has a fairly aggressive predatory lending statute, even that doesn't stop unsavory lenders who are engaging in the business and trying to make a quick buck. And then there are the subprime lenders that I still, even after a series of hearings, haven't been able to figure out who regulates. The ones that are subsidiaries of national banks at some level, but somehow have some kind of shield between them and the regulators, I haven't quite figured that out yet.

So I am not even going to try to engage in this debate with my colleague from North Carolina. I won't even read the story that he read quite like he read it, but that is a subject for another day.

What I would like to know is from my friend from the Fed, I was pretty abusive to the Fed the other day at the credit card hearing, but there is one suggestion here that OCC has made, Ms. Bair has made on behalf of the FDIC, that there needs to be joint rulemaking authority. OCC, FDIC is not currently authorized to do some things that the Fed and maybe the FTC are authorized to do. And they I think, for the first time, I have heard them affirmatively say Congress ought to expand that authority.

What is your view and what is the Fed's view on that, if you would?

Mr. KROSZNER. Thank you. That is a very important question. One thing I think that is very important to realize is that the enforcement authority is there regardless of whether there is a particular rule.

Mr. WATT. We are talking about joint rulemaking. You can only enforce rules that the Fed will make, and I can tell you that there were a lot of unhappy people in the room when we were talking about credit cards, when we were talking about the rules that you all have made or the lack of rules that you all have made. And

there is some dissatisfaction with the lack of rules that you all have made. So I am going to get to the enforcement question if my time doesn't run out, but I want to know, does the Fed have a position on what is being advocated on giving the OCC and the FDIC joint rulemaking authority within this area?

Mr. KROSZNER. The Federal Reserve Board has not formally discussed this issue, so we have no formal position.

Mr. WATT. Are you all planning to take up that issue? Would you encourage them to take it up at your next meeting and let us have your formal position on it? I think we finally got the formal position of the other regulators that are sitting beside you. They have kind of told us that off-the-record, but I think from my perspective, this is the first time I have heard it in a public hearing venue where they aggressively said, give us this joint rulemaking authority. So it would be nice to hear from you.

Now, second, on the enforcement issue, I am wondering, Mr. Miller, if the Feds got the regulatory authority under Watters now to basically have absolute authority to make the rules, what implications does that have for enforcement of those rules that are made at the State level by attorneys general even though the rules that are being enforced are articulated at the Federal level? Do you have that authority and could I have the opposite view or the other view on that, maybe it is not the opposite view, on whether maybe something needs to be more aggressively done to make it clear that even when you all make the rules for Federal regulated institutions the States still have the authority to enforce those rules?

Mr. MILLER. In some limited areas, but important areas like telemarketing rules, when the FTC does telemarketing rules the States have the authority to enforce that. And in a subprime area to give us the authority to enforce the Federal rules, I think, would make a lot of sense for all the reasons that we have mentioned, including the resources. I would offer one sort of caution about joint rules. I think that it is important to give the OCC rulemaking and the FDIC in deceptive and unfair practices, but if you give all the agencies jointly the rules, then—

Mr. WATT. I probably misstated that. I am actually advocating for exactly what you are saying, but then having them get together and hopefully do it jointly, but giving them each one independent authority to do it.

Mr. MILLER. That would be the way to do it, and have them consult, of course, and try to work together. But otherwise you could get into stalemate and lowest common denominator, and I don't think you want to go there.

Mr. WATT. Just to get the other side on the enforcement issue from Mr. Dugan and Ms. Bair.

Mr. DUGAN. I think there is a statutory prohibition on unfair and deceptive practices that we are talking about, and we can take enforcement actions just under that without a Federal Reserve rule with respect to that. That is something that we kind of pioneered among all the agencies.

Mr. WATT. I am only talking about State.

Mr. DUGAN. On that count, when the Federal Reserve issues a rule under this that applies to lenders, it applies to all lenders, not just bank lenders. To the extent it applies to nonbank lenders you

do need an enforcement mechanism. I believe that, I think this is right, that the State attorneys general already have that authority to enforce that rule if a rule is written. I believe that is correct.

I am sorry, that is only with respect to HOEPA, which is the high cost loan thing. To the extent that is not provided here, I think it would be a useful thing to do.

Mr. WATT. Thank you very much, Mr. Chairman.

The CHAIRMAN. Would that have to be statutory?

Mr. DUGAN. I think it would have to be statutory.

The CHAIRMAN. To the extent that we have touched on things where you think we would need a statutory change to fix things up, follow up with us and let us know.

The gentleman from Georgia.

Mr. SCOTT. Thank you, Mr. Chairman. Much has been said. This has been a very, very informative and a very, very good hearing. But we have a serious problem of lack of faith and confidence of the financial consumer being protected. We have soaring foreclosure rates, we have subprime lending, predatory lending, and deceptive credit card practices. And nowhere is that more impacted than those at the lower end of the economic scheme, which makes it all the more serious. And so while some will argue that the State is in control, or it is the Federal, these poor people are out there just looking for help, they are looking for protection. So I think that we need to establish certain facts. I think one is, without question, State regulators are in need of clear and concise explanations of what their role in regulating should be and will be in the near future, and how State and Federal authorities can work together to ensure above all else that there is protection of the financial consumer.

And with that as a premise, I think we need to ask some questions about the infrastructure at work here between the Federal and the State level. I would like to ask a series of questions and maybe get some quick answers because my time is short. The first thing is, in your opinion, and any one of you can answer these, or if two can chime in with quick answers, I would appreciate it greatly. First of all, should Federal banking law bar States from regulating the activities of State chartered subsidiaries of national banks?

Mr. DUGAN. The answer from the OCC is yes, and the Supreme Court just agreed with that position.

Mr. POLAKOFF. And the answer from the OTS is yes.

Mr. SCOTT. What do you believe should be the appropriate scope of the National Banking Act?

Mr. DUGAN. I think the scope should be to the activity, all activities in national banks, both from the safety and soundness and the consumer protection side of what they do.

Mr. SCOTT. Do you believe that State regulation of national banks helps or hurts the consumer?

Mr. DUGAN. I guess what I would say is that it is duplicative, and it would be a better use of resources to have States focus on the place where they can bring the most attention to things that aren't otherwise done, and that we should be held accountable to do what we need to do at national banks.

Mr. MILLER. I dissent of course. I think that the States and the Feds both doing it in this important area is the best of both worlds and is the kind of federalism and checks and balances that our Founding Fathers intended for this kind of situation.

Mr. SCOTT. You know, I agree with you, Mr. Miller. I love history, and perhaps one of the most fascinating chapters of American history is the layout of our financial systems and the checks and balances that basically the architect of which was Alexander Hamilton, who made it very clear to us and has yet in my opinion to receive the proper credit that he rightfully deserves. But with that, if Hamilton were here, I think he would ask this question: How much deference should be given to a Federal agency's determination that their regulations preempt State law?

Mr. MILLER. I think that obviously there should be some deference, some considerable deference. I think the exception, though, would be with the OCC and the OTS who are competing with the States for bank charters, that when that competition continues, and certainly the temptation or the implication is that we are going to go easier on you than they will, so come with us, and then put a different hat on and say, okay, we preempt the States. That is not a good situation. So I think because of the existence of that situation, the deference to those two agencies should be diminished or indeed eliminated.

Mr. POLAKOFF. If I could offer two thoughts for your consideration. The first is that preemptions are a rather fascinating discussion, and recently there have been three States that have actually preempted their city or county ordinances. So preemption exists at each level, sir.

The second is that, at OTS, when we are asked for a local opinion on a preemption issue, we do share that legal opinion with CSBS and with the affected States. I am not suggesting that we are asking for an equal contribution, but I do want to share with you that we do share that before finalizing our opinion.

Mr. SCOTT. Thank you very much. I have one other point here. I have heard from my consumer groups in the State of Georgia. The State of Georgia has been a leader in the Nation of foreclosure preemption. You name the abuse, you name a need for protection for financial consumers, and my State of Georgia, unfortunately, is the poster child for that. And many of the folks back home argue that Federal regulators cannot adequately police consumer protections that they have worked to promote. Is that a fair statement?

Mr. DUGAN. I don't think it is a fair statement with respect to national banks. But of course we cannot promote consumer protections with the places where predatory lending is most in evidence. And it is not in the national banking system, it is not in insured depositories, it is outside of them. And we don't have any jurisdiction over that. That is absolutely true.

Mr. SCOTT. And then I have constituents on the other side, national banks for example. They complain that they shouldn't have to spend the money or time complying with both Federal regulations and the rules of the various States in which they conduct their business.

Mr. DUGAN. Well, I think that is the essence of the dual banking system and that is the essence of the national banking system his-

torically, going back to the very strong advocate of a national bank charter, which was Alexander Hamilton, which is that a set of uniform rules that apply to nationally chartered banks is the system that Congress set up to be and the reason why it has gotten the kind of deference it has gotten in the courts over the years. That is the principle.

Mr. SCOTT. Finally, Mr. Chairman, if I may, just to conclude, do you believe supervision over national banks and their subsidiaries is adequate to ensuring financial customers are being treated fairly? This is especially as a crisis in the subprime lending market, and foreclosure numbers across the country are not foreseen as letting up any time soon given the crisis.

Mr. DUGAN. I do believe we have the resources. We are not perfect. The banks we supervise are not perfect. But I believe our record on those subprime loans that you are talking about is a strong one.

Mr. SCOTT. Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from Texas.

Mr. GREEN. Thank you, Mr. Chairman. And as usual, Mr. Chairman, you have provided great oracularity in helping us to better understand these issues. I believe that the perception exists in the minds of many consumers, a great number I might add, that they are being, to use a highly technical term, "ripped off" by some of these fees, fees that are noninterest income. They believe they are being ripped off. And Chairwoman Bair, on page 3 of your statement, starting in the second paragraph, a few lines down, you indicate that fee based overdraft protection programs typically charge customers at least $20 to $35 for each overdraft. Depending on the size of the overdraft and length of time for repayment, the effective annual percentage rate can exceed 1,000 percent. And then you go on to indicate in the next paragraph that last year insured institutions obtained 42.2 percent of their net operating revenue from noninterest income. At some point someone might conclude that this is rapacious and that it is invidious and that something more than a notice is appropriate.

The truth is that a disclosure of an invidious practice, while it would disclose it, it won't eliminate it, and it won't obviate it. You just tell the person that if you do a certain thing you will have this practice to contend with. And it seems to me that at some point we have to try to end some of these rapacious and invidious practices.

Let me just cite one or two maybe. The ranking member talked about the overdraft problem. You cash the check and you make a deposit at the same time you are cashing a check or writing and having the check honored. The deposit does not have the same rate of speed with reference to becoming a part of the system that the check that you have written seems to matriculate through the system. Credit cards, and perhaps I should ask this question before I make a statement of fact, so let me ask. If I charge something on a charge card and right immediately after charging decide that I don't want it, and I return it and get a credit to my account, is it true or not true that the credit may take longer to reach my account than the charge?

Mr. POLAKOFF. Congressman, I could offer from a personal perspective that while it may take longer, there is not an obligation to pay the amount of the expected credit.

Mr. GREEN. I understand. But consumers are of the opinion that these things ought to move at about the same rate of speed. If you take my money on day one, perhaps I ought to get credit on day one, especially if I hand it back to you right after I have made the charge. I charge, I give it right back, the charge hits my account, but the credit shows up some days later. These kinds of practices are, I think, what is causing the consumer to think that some of us are not fulfilling our obligations to protect them. Universal defaults, double cycle billing, these things are repugnant to the consumer. And while I hope that we can cure them with notices, I am not sure that notices alone are sufficient.

One more comment. Mr. Miller, I really admire your optimism. You talk about folks getting together and working it out. There are two great powers, many great powers, but there are two that I will speak of in the universe. One is "way power," the ability to find a way. The other is willpower. Many times we can see the way, but we can't find the will, and I am hopeful that the will will manifest itself, because if we do have the will, and I am convinced that this august body can find a way.

So my question is this: Having said all of this, do you find any—is there any practice that is rapacious, repugnant, and invidious to the extent that there ought to be some rule that would alter it? And I have cited a few. So why don't we start with the Fed.

Mr. KROSZNER. Certainly it is very important to protect consumers and to make them feel that they are being dealt with fairly and to make sure that they are dealt with fairly. I certainly agree with that. And one of the rules—

Mr. GREEN. May I just intercede? And I would beg that you accept my interceding for just a moment. Could you kindly start out with yes or no? That way I will know what you really said, because sometimes when folks finish, I don't know whether they have said yes or no. So could you start with yes or no and then give me all the explanation you would like within about a 10-second period of time?

Mr. KROSZNER. Yes. Under HOEPA, we have undertaken a rule against loan flipping, which we thought was unfair and deceptive and inappropriate, and so we prohibited that practice. Tomorrow I will be holding a hearing where we are going to be discussing other potential practices that we would consider for a prohibition.

Mr. GREEN. Mr. Dugan?

Mr. DUGAN. Yes, there are. We have had to take action against some of these. You know, we don't have the rulemaking authority. But just to give you one example, in the area of secured credit cards, we saw a practice where people were charging the amount of the security to the card, and as a result, there was nothing left for the consumer to borrow. And that would be the kind of practice that we certainly would think rises to the level of something that just shouldn't happen.

Ms. BAIR. Yes, exploding ARMs. These payment-shock mortgages that people have no realistic chance of repaying, are what the Subprime Mortgage Guidance is all about, getting rid of those.

Also, I think regarding fee-based bounce protection, we are undergoing a careful review of that practice. That product is used chronically. It is extremely high-priced, and we want to do more fact-finding about how customers are using it.

Ms. MAJORAS. Sure. The FTC, we have lots of cases alleging that facts were deceptive or that they were unfair in the financial services area. We had one recently in which the mortgage lenders were providing all sorts of terms to Spanish-speaking consumers in Spanish, but then changing the terms and giving them documents in English that they couldn't read that had wholly different terms for the mortgages. So, yes, of course there are practices, and we attack them regularly.

Mr. POLAKOFF. Congressman, absolutely. Our 2005 guidance on overdraft protection is a perfect example where it is unacceptable for a consumer to go to an ATM and ask for the available balance and have included in that the overdraft protection amount without any notice of the charge associated with accessing that.

Mr. GREEN. My final question is, to what extent were these corrections published?

Mr. DUGAN. Ours was published.

Mr. KROSZNER. We issued a formal rule.

Ms. BAIR. Yes. For subprime mortgages, again, we have imposed very public formal enforcement actions, and also the Subprime Mortgage Guidance obviously is public.

Ms. MAJORAS. We filed a case in court and issued a press release and the like.

Mr. GREEN. Thank you, Mr. Chairman. I yield back the balance of my time.

Mr. CLEAVER. [presiding] The Chair now recognizes the gentleman from California, Mr. Sherman.

Mr. SHERMAN. Thank you.

Comptroller, if the OCC determined, either by rule or interpretation, that realistic brokerage is a permissible activity for national banks, would you then view State real estate licensing laws as either obstructing, conditioning, impairing, or interfering with national banks' ability to engage in such activity, and then go on to preempt those State licensing laws?

Mr. DUGAN. Mr. Sherman, we have no such rule in our book to permit real estate brokerage and I have no intention of doing so as long as I am Comptroller.

Mr. SHERMAN. That pretty much puts that question to rest.

We need consumer protection. We need more of it than we have now. If we have the States do it, then a lot of people who live in States where they get inadequate consumer protection, a few will live in States where consumer protection is so intense that it interferes with business and raises costs, and the whole country will suffer, because we benefit from an efficient national economy. In fact, this union was formed perhaps more than for any other purpose to give us the benefits of living in the world's first common market where companies could do business across State lines and now across the continent.

We could act through the Federal agencies. I think you have some prodding here today, but there is more for you to do. Or finally, we could pass laws through this committee. They are subject

to possible veto, and they are also subject to a congressional schedule that is now being drawn out on the Floor. I don't know how good we would be at writing good consumer protection if we do it on 3 hours' sleep, which appears like it is going to be the norm for a while here in Congress.

My hope, therefore, is that the agencies represented here move forward with consumer protection, and there are two kinds of consumer protection. One is disclosure, where it provides good information, is always helpful. And the other is when you prohibit an activity, and the problem there is—I will give you an example. Let us say you have a group of subprime borrowers, and they can't qualify for anything but the really tough subprime loan. If those loans tend to have a one-fifth default rate, you would say, my God, what kind of lender is making those loans? We have to stop that. But if you stop it, then you have stopped—for every foreclosure you have stopped, you have stopped four people from ever owning a home.

So I don't know what the default rate is. If you aim to tell those financial institutions that you regulate to aim for a 1 percent default rate, a lot of people aren't going to be able to own homes. If you allow them to make such loans on such extreme circumstances that they have a 50 percent default rate, first they are going to go bankrupt, but second, we don't want to see those kinds of loans made.

As a disclosure, we have these credit cards out there, and the statement tells me what my annual percentage rate is, and it tells me what my minimum payment is. Should we by law or regulation require that it say, Mr. Sherman, if you choose to make the minimum payment, even if you don't use this credit card for any future purchases, it will take you "X" years to pay us off, and in addition to paying us the "X" dollars that you owe, that we were going to add "Y" dollars of interest?

Now, I realize people continue to use their credit cards, but would it be helpful to American consumers if we knew if I have this balance at the current interest rate, eliminating the effect of any teaser rates, this genuine effective rate, and I choose just to make those minimum payments, what am I in for both in terms of how long am I going to be making those payments, and the total amount of interest I am going to pay? I will let anybody respond to that.

Mr. KROSZNER. Certainly our proposal that was discussed in the subcommittee of this committee a week ago tries to address exactly that issue. One of the things that we did is we talked to real consumers and asked them, what do you need to know? What do you want to know? What is going to be helpful to you? And then when we have those answers, tried to put that together in a way that was useful to them, and then asked them, well, is this helpful? Can you understand that?

And so our proposal is getting at exactly these kinds of issues, and as part of our proposal, we have discussed disclosing precisely that type of information. We are now in a comment period, so we are very open to comments from consumers, and from other parties who might tell us how useful that is and how to improve that.

Mr. SHERMAN. And I hope in the limited time that one of the things you put forward to consumers was a little table: If you make the minimum payments, this is how long it is going to take, this is the total amount you are going to pay, and this amount is going to be your interest, and this is your principal.

I do have a quick question on home lending, and that is, we have seen home mortgages make the people who would never qualify to be able to pay the fully indexed adjusted amount. So it is somebody that says, oh, yes, you can qualify for a $500,000 mortgage because you can afford to make $2,000-a-month payments, and that is all you are going to have to make for the first 6 months or a year, at which point it goes to double that payment. Are the financial institutions that each of you regulate allowed to regard a borrower as qualified based upon the teaser rate and not based upon whether they qualify to make the fully indexed payments that will come about in—and I realize they only come about if the index doesn't drop, but assuming the index stays the same.

Mr. KROSZNER. This is precisely the issue that we have put out in our notice of proposed rulemaking on subprime mortgages. And we have gotten comments in, and the agencies are working together to finalize that rule. I think when we looked at the comments—or we are looking at the comments, and we certainly can't prejudge where we are going to be, I believe there is a lot of support for—

Mr. SHERMAN. Isn't this a basic issue of bank solvency? If they go around loaning $500,000 to somebody who can only afford to make $2,000-a-month payments, and they say, well, that is a good-performing loan because we got the $2,000 last month, do you guys—my time—do you guys call that a performing, qualified, good asset loan?

Mr. KROSZNER. We have always taken safety and soundness very seriously and looked at the underwriting standards that are regulating institutions' views. I think the key is making sure that all institutions use similar types of of high-quality underwriting standards.

And just to address the previous question, it is precisely the table that you described that is in our proposal on credit cards. So I think we have tried to address both of the concerns.

Mr. SHERMAN. Thank you for the credit card answer. Hopefully, for the record, you can provide a somewhat better answer on the home mortgage issue, and I will yield back.

Mr. CLEAVER. Thank you.

The Chair now recognizes the gentleman from Minnesota.

Mr. ELLISON. Mr. Dugan, in the Watters case, basically, the Supreme Court construed the National Banking Act, and essentially, you know, the Act vested nationally chartered banks with certain powers and, "all such incidental powers as are necessary to carry out the business of banking." But within the statute, doesn't it also say that there are certain exceptions that are carved out under the Act, and if the Congress wants to regulate in those exceptions, that they certainly can, right?

Mr. DUGAN. Congress can—we are a creature of Congress. You can change the National Bank Act in any way that you see fit.

Mr. ELLISON. Yes. So I guess my question is this: In the area of—I mean, I know what the decision says and all, but in the area of consumer protection, don't you think having more eyes on the problem to protect consumers would augment the Fed's work in terms of looking out for the consumer?

Mr. DUGAN. As I said earlier in my testimony, I believe that if we had an unlimited number of resources, and an unlimited number of staff to have 2 sets of eyes, 3 sets of eyes, 10 sets of eyes, would obviously put more compliance on an institution, but we don't.

Mr. ELLISON. I know that, but let me just say this. If the States were allowed to help protect consumers as it relates to Federal banks or State-Chartered subsidiaries of Federal banks, that would mean you would have more eyes to protect consumers, isn't that—

Mr. DUGAN. To me what makes the most sense is these are very heavily regulated institutions that we regulate, and we believe we should be held accountable for that. That is what we spend our resources on.

Mr. ELLISON. Right.

Mr. DUGAN. To duplicate that effort to me doesn't make any sense.

Mr. ELLISON. Sure. Let me ask you the question this way then. You know, there are banking practices by national banks and State charters that are owned by Federal banks that have been called into question to date; isn't that right?

Mr. DUGAN. Certainly.

Mr. ELLISON. Yes. And as a matter of fact, I think you said that—and maybe I got this wrong, but I thought you said that the Fed maybe was—I am not sure of the time period. I think it was last year—had like 200 formal actions and 200 informal actions. Did I get that right?

Mr. DUGAN. I said the OCC.

Mr. ELLISON. The OCC.

Mr. DUGAN. 200 over a 5-year period.

Mr. ELLISON. My mistake. I misidentified the Agency. But we are on the same page. That doesn't seem like a lot to me, given so many of the things that I have been hearing about from my constituents.

Mr. DUGAN. Well, all of what I said was—this is a very good example. There are many actions that we take that never arise to even an informal action, particularly in something that we call "matters requiring attention," and that is where we first alert bank management of a problem because we are supervising them and we are in there. We see it. We have a problem. You need to fix it. And there were, over the same period, about 1,500 matters requiring attention.

Mr. ELLISON. This is over a 5-year period?

Mr. DUGAN. A 5-year period on consumer-related issues only.

Mr. ELLISON. Fifty States?

Mr. DUGAN. It is the national banking system, yes.

Mr. ELLISON. Plus the territories?

Mr. DUGAN. Yes.

Mr. ELLISON. I can even see how that is not that many.

Anyway, let me ask Attorney General Miller about this. Do you feel that there is room for the States to regulate in the areas that were precluded by the Watters decision? I mean, do you feel like you could help the citizens of your State notwithstanding Watters?

Mr. MILLER. We could help our citizens a lot. The States, the attorneys general, the banking superintendents, have a lot of expertise, have a lot of resources to contribute here. You know, it is particularly difficult when there is a State-chartered institution that is sheltered from our authority or a State law that we are prohibited from enforcing. It just doesn't make any sense at all.

Mr. ELLISON. For example, if a national bank or a State-chartered bank that is a national subsidiary had a credit card section, and they were doing things like, I don't know, double-cycle billing, universal default, pay to pay, all the stuff we have been talking about, you can't touch them; is that right?

Mr. MILLER. That appears to be the case. And, you know, the credit card complaint is the poster complaint for this whole issue, and the whole—why this context that we have gotten into doesn't make sense. And we will handle that individual complaint at the local level makes just so much sense.

Mr. ELLISON. We live in a country that has negative savings; people are relying on credit cards to make it. They are at a competitive disadvantage with the banks, and yet their own State that they live in is without the power to do anything for them.

Mr. MILLER. That is the dilemma, and that is why it doesn't make sense.

Mr. ELLISON. Let me ask you this question, Mr. Miller. The argument goes something like this: We don't want the States to have their own—to be able to regulate in this area or to enforce in this area because it would drive up the cost of doing business because it would cost the national banks money, and, I guess, lawyers, to comply with these various States. So if this is essentially a cost-saving measure, why don't we see the costs of lending practices going down? You would think they would be lower. You would think we would have really cheap money in America.

Do you have any thoughts on this subject? Could I at least get an answer, Mr. Chairman? I mean, you know, one could argue that the cost of money is pretty high because there is only—you know, when you look at some of the practices we have been talking about today.

Mr. MILLER. I think you can draw that conclusion.

The other thing is that, you know, we are a large, complex, efficient country. And, you know, today banks and institutions know how to, in a cost-effective way, efficiently comply with the whole set of rules and regulations. That is not really what we are talking about. We are really talking about the authority question, between States and Federal. We are not talking about cost here.

Mr. ELLISON. Mr. Chairman, unanimous consent for 30 seconds?

Mr. CLEAVER. Yes, please.

Mr. ELLISON. Now let me ask you, if the national banks and the State subsidiaries that are owned by those national banks, if we really should—I mean, do you think we should be seeing cost savings as a result of the national scheme? And in your view, are we seeing the benefits of what should be a cheaper, more cost-effective

system, or have we simply given certain banks sort of a free hand and fewer people to hold them accountable, and, therefore, they are in more of a monopoly position and can charge consumers higher prices because there is fewer people watching them; is that possible?

Mr. MILLER. I suppose that is possible. I guess what I am saying is that obviously we are not seeing lower charges, and that is either because there really isn't a cost saving by going to the national system, or if the advocates are right, there is additional profit. But I think it is really a question of power and authority and how we treat consumers. I have said, though, that, you know, I respect the Supreme Court decision. I have to live with it. The chairman said earlier, I think, correctly—

Mr. ELLISON. I don't.

Mr. MILLER. Yes. I mean, you can change it. But the chairman said earlier, the prospects of changing aren't so great. So, you know, what do we do now?

And, you know, one of the things I talked about is that seven of us really work together, use our powers in the subprimary. We all have power; we have retained power there. And, you know, we just have this enormous opportunity to change that system, particularly with bad actors out, relatively good actors remaining, those with national—with reputational interests remaining, and having that incentive—some pain being felt including by the investors and the public knowing this is a problem.

Going forward, if the seven of us really work together sincerely and practically, as the two of us at the end of the table have worked together for the last 5 years, we could have a much, much better subprime market.

Mr. CLEAVER. Thank you.

The Chair recognizes the gentleman from Ohio, who has worked on this issue in the Ohio Legislature, Mr. Wilson.

Mr. WILSON. Thank you, Mr. Chairman.

Ladies and gentlemen, I am fully aware this has been a long, long time, so I will be brief. However, I have made some observations, and I appreciate the seven of you being here, and so I will just ask my question in this way.

One of the things that came out today to me is that there are some—we need to work on connecting the dots, be that State or Federal, how we can ask the FTC to step up, the Feds, Federal Reserve, and what we can do with the OCC? I think a lot of questions, Mr. Dugan, were directed to you for some obvious reasons. So without saying anything negative, I really thought that Attorney General Miller had some really good observations in his testimony and saying what things we need to do.

My question would be—and I would like to go through the seven, and just give me a brief response—is what can we do on the congressional level to help you connect the dots to put this together so that we can make a better situation for the people in America and certainly for those in Ohio? If I could.

Mr. CLEAVER. We are going to ask all of you to answer the question and give the Reader's Digest version.

Mr. KROSZNER. The Reader's Digest version is you actually already have taken a very important first step in including the Con-

ference of State Banks Supervisors in the FFIEC, the FFIEC Act. So they are participating, and it is making it easier for us to coordinate.

Mr. WILSON. Thank you.

Mr. DUGAN. We made four suggestions. And for Congress one would be to give joint rulemaking authority for unfair and deceptive practices. We also think that when regulators write rules that other regulators have to enforce or implement, that they should be consulted as part of that process. I think that gets very much to your connect the dots kind of thought. And then I think that Congress should require that these consumer protection regulations be updated on a regular basis, that they sometimes can go too long without being reviewed, and that causes problems for consumers over time. And then lastly—and this isn't a congressional thing, but it was something that was raised earlier. I think we all need to get together to adopt a centralized way of handling consumer complaints so they don't get confused about who is a national bank, who is a savings association, etc.

Mr. WILSON. Thank you.

Ms. BAIR. Yes. I think you have hit the nail on the head. As I said in my testimony, we need uniform, consistent, across-the-board protections. I have called again for national standards to address abuses in subprime mortgage lending at both bank and nonbank lenders.

We would like the ability to write rules regarding unfair and deceptive practices. We need to expand the ability and the authority of State bank supervisors, as well as State attorneys general and others who are involved in regulating nonbank providers, to enforce the existing Federal protections.

And finally, although financial education is not a panacea, I do think there is an opportunity for Congress to fund more financial education in public schools in their core curricula. In the longer term, I think that would help.

Ms. MAJORAS. I think the crux of the matter is to decide what we want to do with the nonbank lenders who are the major participants in the subprime market. They are currently not regulated at the Federal level. So I think that is one decision that needs to be made.

Second, we think that mortgage disclosures based on a study we have just released are inadequate, and we think we should look at that.

And finally, if you are going to revise the FTC Act, it is one thing to give others more authority, and I don't have an opinion on it. That is up to them what they need. But if you change our standard and our enabling statute, remember that the FTC enforces in broad swaths of the economy, not just this, and that would change it for everything.

So I do hope we can work together with those who are making such proposals because, of course, we use that statute every day all day, and we know what it can do and what it can't do. Thank you.

Mr. WILSON. Thank you.

Mr. POLAKOFF. Congressman, the Reader's Digest version, three issues. The FFIEC, which is a very effective tool for all of us. There is a consumer forum, I think the Comptroller mentioned it earlier,

headed by Treasury, and I believe virtually all of us at the table, including CSBS, and the FTC, and the banking regulators, sit at that forum and have very robust discussions, and I think that would—they are the two most critical aspects.

The last is I would commend CSBS and ask them to remain vigilant. Right now only 70 percent of the banks have adopted the nontraditional mortgage guidance. CSBS is very active in getting other departments to enact that guidance, and I think that is critical.

Mr. WILSON. Thank you.

Mr. MILLER. One of the great roles of Congress is oversight. I think the most important thing you could do is hold the seven of us, our feet to the fire, make sure we fully and fairly and effectively use our powers, and make sure we work together to protect consumers.

Mr. WILSON. Thank you.

Mr. ANTONAKES. Well, presuming overturning the decision isn't an option, we would speak for the FFIEC on an expanding role and have joint rulemaking through the FFIEC. We think we are just one of six parties, but we think we bring extensive consumer experience.

Mr. WILSON. Thank you. And if I may, Mr. Chairman, in my opening statement, I said what I really felt our issues were, and the fact that it is not all bank-related, certainly that most is not. But this has been very helpful to me, and having sat through this just last year in Ohio, we have a lot of work to do, and we truly want to be able to bring all seven of you together in looking at how we can improve on the States and the Federal level. So I look forward to working with you in the future.

Thank you, Mr. Chairman.

Mr. CLEAVER. Let me express appreciation to all of you. Ms. Bair, you have spent quite a bit of time with us over the last few weeks, and we appreciate you coming and being responsive, as you always have been.

The Congress was in session until about 2 a.m., so you have seen the hearty Members today, and we feel very strongly about this. I think the chairman expressed at the opening of the hearing that this was designed for us to learn, and so I think that, in fact, has happened. Some Members may want to ask additional questions, and if they do, they will do it in writing. And without objection, the hearing record will remain open for 30 days for members to submit any additional questions to the witnesses, and to place their responses in the record.

If there are no requests to speak, this hearing is adjourned.

[Whereupon, at 1:30 p.m., the hearing was adjourned.]

A P P E N D I X

June 13, 2007

Opening Statement
Rep. Carolyn Maloney
June 13, 2007

Thank you, Mr. Chairman.

As the Chair of the Subcommittee charged with consumer credit, I am very pleased that you have convened this hearing of the Full Committee to highlight and discuss some of the overarching issues of federal and state consumer regulation that we have been working on in my subcommittee in the context of specific regulatory debates. Whether it is in the context of credit card regulation or subprime mortgage lending, the fact of growing OCC preemption requires us to ask who is best able make new rules and who can enforce them.

It may be correct, as the OCC says, that the Watters decision changed the law very little if at all. But in legal history books, I believe, it will be seen as marking the end of one era and the beginning of the next. I hesitate to announce the impending death of the dual banking system, but I wonder what meaningful role is left for state regulators.

As a Member of Congress I am inclined to believe that elected officials are the most responsive to the needs of their constituents, and as a New Yorker I know that an active state AG is a very effective consumer protector.

On the other hand, in today's global market we may no longer be able to afford the luxury of having the most banking regulators in the world. Uniformity may be an advantage we can no longer afford to do without.

So I'd like to see the federal regulators prove they can take up this responsibility and build a record on consumer protection to match the record they have built on safety and soundness.

For instance, I'd like to see the Fed use its unfair and deceptive practices authority to regulate in both the subprime mortgage area and in the credit card area to ban abuses.

As I suggested last week maybe we should extend that power to the other agencies as well so that there would be more regulatory vigilance. Joint rulemaking would give a seat at the table to the various sectors and provide more input and different views.

I'd like to see the OCC and the FDIC ramp up their staffing and resources to make it possible for consumers to call and complain and get a helpful response. Structurally, I am concerned that the consumer protection sections of the agencies should have direct access to the top decision makers and a seat at the head table.

I also think we should support and encourage efforts by federal regulators to work with states. For example, the OCC and the Conference of State Banking Supervisors have agreed on a model framework for sharing consumer complaints that has been put into place first in my state with an MOU between the OCC and the New York State Banking Department.

I hope we can explore these and other issues and I look forward to the testimony.

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Opening Statement –Consumer Protection Hearing
Rep. Dennis Moore

- Mr. Chairman, I just wanted to take a few minutes to talk about the issue of consumer complaint resolution at the regulatory agencies.

- Before I came to Congress, I was a District Attorney, and I investigated and successfully prosecuted a national oil company charged with rigging gas pumps to cheat consumers. Those consumers had filed complaints with the Consumer Protection Division of my office at my direction, which was a fairly straightforward process, especially compared to that faced by banking customers today.

- The average consumer often has no idea where to file a complaint when something has gone wrong at their bank.

- In the past, a consumer would often call his state banking regulator or attorney general's office, but recently the role of the states has been significantly reduced. When it comes to the federal regulators, most consumers have never heard their names – other than the FDIC, whose name is on every bank's door.

- Even if the consumer can find the right federal regulator, it is often then hard to find the consumer complaint resources on the regulatory websites. Some of them require a great deal of searching to yield a telephone number or a complaint form. And when the consumer submits the complaint to the regulator, the process itself can be confusing and intimidating.

- This Committee needs to feel confident that, if consumers have fewer opportunities to go to state regulators for satisfaction, the federal regulators are doing all that they can to make the process efficient, consumer-friendly, and are using what they learn from consumers to push financial institutions to better performance.

- Generally, consumers are seeking assistance from regulatory agencies because they have experienced some level of frustration with their bank. We owe it to them to ensure that the process they encounter and the resolution they receive is not a source of greater frustration than the original complaint. Thank you.

Opening Remarks
Honorable Maxine Waters D-35th CA
House Committee on Financial Services
Hearing: "Improving Federal Consumer Protection in Financial Services"

Wednesday, June 13, 2007
10:00AM
2128 Rayburn House Office Building

Good morning ladies and gentlemen. I want to thank Chairman Frank and Ranking Member Bachus for holding today's hearing on Improving Consumer Protection in Financial Services. Given the recent regulatory and judicial actions affecting the application of state consumer protection laws to national banks and state thrifts, it is very proactive that the Committee would hold this hearing.

The number of consumer complaints related to financial services and lending practices as well as to unfair and deceptive practices in the financial services marketplace raises issues about the appropriate role of the states in the consumer protection and regulatory equation; it also calls into question a number of federal statutes --- Truth in Lending Act (TILA) and the Fair Credit Reporting Act (FCRA), not to mention the Equal Credit Opportunity Act (ECOA). We all know that consumer protection is different depending on the state and the practice in question.

I am pleased to say that some of the best practices related to consumer protection were pioneered in my State of California and remain a model for other states as well as the federal government today. However, I am afraid that during the past several years, some of the consumer protections have not been as vigorously enforced as they could have been; just look at the identity theft issue and current protections for the consumer as an example. We all know that the statutes governing consumers are at the core of credit in a world where credit is often a key to financial success.

As we witness a continued increase in the number of seniors and first time credit applicants from diverse backgrounds, we will want to make sure that the vast array of tools to protect these individuals work rather than make them into victims. I look forward to today's witnesses sharing their perspectives on these important consumer related issues. Thank you.

TESTIMONY OF

STEVEN L. ANTONAKES

MASSACHUSETTS COMMISSIONER OF BANKS

On behalf of the

CONFERENCE OF STATE BANK SUPERVISORS

On

IMPROVING FEDERAL CONSUMER PROTECTION IN FINANCIAL SERVICES

Before the

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

June 13, 2007, 10:00 a.m.

Room 2128, Rayburn House Office Building

Introduction

Good morning, Chairman Frank, Ranking Member Bachus, and distinguished members of the Committee. My name is Steven L. Antonakes, and I serve as the Commissioner of Banks for the Commonwealth of Massachusetts. I am also the Chairman of the State Liaison Committee (SLC), making me the newest voting member of the Federal Financial Institutions Examination Council (FFIEC).[1] It is my pleasure to testify today on behalf of the Conference of State Bank Supervisors (CSBS).

CSBS is the professional association of state officials responsible for chartering, supervising, and regulating the nation's approximately 6,200 state-chartered commercial and savings banks. For more than a century, CSBS has given state bank supervisors a national forum to coordinate, communicate, advocate and educate on behalf of state bank regulation.

I commend you, Mr. Chairman, for calling this hearing to discuss consumer protection in financial services. As a state regulator, I am deeply committed to protecting the consumers of Massachusetts. The states have long been recognized as leaders in providing consumer protection. And while I also strive to encourage the success and competitiveness of the financial institutions my department regulates, I will not compromise my department's fundamental commitment to protect consumers and to ensure the safety and soundness of the institutions we regulate.

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[1] The Federal Financial Institutions Examination Council (FFIEC) is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions by the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS) and to make recommendations to promote uniformity in the supervision of financial institutions. In accordance with the Financial Services Regulatory Relief Act of 2006, a representative state regulator was added as a member of the FFIEC in October 2006. The FFIEC website is http://www.ffiec.gov.

CSBS is committed to working with Congress and our federal counterparts to further the development of a fair and efficient system of consumer protection that serves the interests of financial services customers. At best, the current regulatory structure at both the state and federal level can be confusing to the consumer. I believe that state and federal regulators and Congress all seek to provide adequate consumer protection.

As financial institutions engage in interstate and nationwide operations, our regulatory system must reflect this evolution. However, I am concerned that in this drive toward a nationwide, multi-state system, we are losing the greatest strengths of our state-federal system and threatening the health of our community banks.

CSBS believes the evolution and increased scope of preemption of state laws threatens to result in a nationwide weakening of consumer protection provisions. In addition, the Supreme Court's decision in *Watters v. Wachovia* has arguably given support for the preemptive efforts of the Office of the Comptroller of the Currency (OCC), which provide an advantage to the federal charter over the state charter, and thereby weaken the dual banking system and the states' ability to protect its citizens.

Congress needs to clarify the role of the states concerning the application of state consumer protection laws and the enforcement of both state and federal laws in protecting the citizens of their states. As the industry continues to consolidate under the federal charters, and supervisors located in Washington, D.C. take on a greater role, the state legislatures need a clear statement as to what options they have to combat such abuses.

History of Preemption and Congressional Intent

Historically, the principle that governed the interaction of state and federal law over national banks has been that federal law overrides state law where the two statutes directly conflict, or where the state law significantly impairs the national bank's ability to conduct its federally-authorized business. National banks and their operating subsidiaries have traditionally been subject to a wide range of state laws, and Congress has consistently deferred to state laws in several areas.

In 1994, Congress adopted the Riegle-Neal Interstate Banking and Branching Efficiency Act (Riegle-Neal Act), which authorized national banks and state banks to establish interstate branches. The Riegle-Neal Act made possible the growth of large nationwide banking organizations and caused dramatic industry consolidation. It also made the application of multiple state laws more relevant to charter choice.

Under the Riegle-Neal Act, national banks that engaged in interstate branching were subject to state laws with respect to intra-state branching, community reinvestment, fair lending and consumer protection (known as "the big four") as if their out-of-state branches were branches of a bank chartered by the host state. In the conference report on the Riegle-Neal Act, Congress declared:

> States have a strong interest in the activities and operations of depository institutions doing business within their jurisdictions, regardless of the type of charter an institution holds. In particular, States have a legitimate interest in protecting the rights of their consumers, businesses and communities....
>
> Under well-established judicial principles, national banks are subject to State law in many significant respects....Courts generally use a rule of construction

> that avoids finding a conflict between the Federal and State law where possible. The [Riegle-Neal Act] does not change these judicially established principles.[2]

These laws, however, were susceptible to preemption by Federal law or by the Comptroller's determination that the state laws were discriminatory. Any branch of an out-of-state, state-chartered bank, however, was subject to all the laws of the host state, with no exceptions. This obviously gave an edge to national banks, which could benefit from the preemption of state laws while multi-state, state-chartered banks were required to abide by multiple sets of laws.

The passage of the Riegle-Neal Amendments Act of 1997 (Riegle-Neal II) expressed the intent of Congress to rectify this competitive disadvantage. In order to restore balance by giving multi-state state banks a meaningful choice in charters, and in part to remove the use of preemption as a means to gain a competitive advantage for the national charter, Congress passed Riegle-Neal II and amended the Federal Deposit Insurance Act to declare that:

1. The laws of a host state (including community reinvestment, consumer protection, fair lending and intrastate branching) shall apply to any branch in the host state of an out-of-state state bank to the same extent as such state laws apply to a branch of an out-of-state national bank; and
2. An insured state bank that establishes a branch in a host state may conduct any activity that is permissible under the laws of its home state, to the extent

[2] H.R. Rep. No. 103-651 (Conf. Rep.), at 53 (1994), reprinted in 1994 U.S. Code Cong. & Ad. News 2068, 2074.

such activity is permissible either for a bank chartered by the host state or for a branch of an out-of-state national bank.

Led by CSBS, the Chairman of the Federal Reserve Board, the Independent Bankers Association, and the National Governors Association all endorsed Riegle-Neal II as a way to provide competitive equality between state-chartered multi-state institutions and federally chartered multi-state institutions. Once again, Congress acted to preserve the viability of the state charter and the dual banking system as a whole and give financial institutions that wanted to operate in multiple states a meaningful choice in charters.

States as the Laboratories of Innovation

The traditional dynamic of the dual banking system has been that the states experiment with new products and services that Congress later enacts on a nationwide basis. The states have been innovators in the area of consumer protection. Nearly every consumer protection regulation that exists at the federal level, or that Congress is currently contemplating, has its roots at the state level. For example, the states were the first to enact fair lending statutes, and are now leading the way on predatory lending, mortgage supervision, data security, and credit card disclosures.

As a matter of fact, I will be testifying tomorrow before the Federal Reserve Board on the home equity lending market. The Federal Reserve has requested that state officials discuss the laws, regulations, and enforcement actions we have taken to supervise the mortgage industry, and provide feedback on what our first-hand experience has taught us. With federal preemption of state consumer protection laws, the Federal Reserve's rule-writing authority under the Home Ownership and Equity Protection Act (HOEPA) is the

most effective method to provide consumer protection in the mortgage lending market. Absent Congressional action, only the Federal Reserve can write consumer protection regulations that will apply to all financial institutions and other mortgage providers. Going forward, it is unclear what role the states will play in developing consumer protection standards as financial products, services, and practices evolve.

Importance of Decentralized Supervision

Maintaining a local role in consumer protection and a strong state banking system is more important than ever as our nation's largest financial institutions merge and the financial market continues to consolidate. These mergers make economic sense for the institutions involved, and offer the customers of these institutions a larger menu of products and services at prices that reflect economies of scale. But the strength of our banking system is its diversity—the fact that we have enough financial institutions, of enough different sizes and specialties, to meet the needs of the world's most diverse economy. Centralizing authority or financial power in one agency, or in a small group of narrowly regulated institutions, threatens the dynamic nature of our economy. As of March 31, 2007, the top 10 insured depositories control 45% of the assets in the system. Nine of these banks are federally chartered and control 44% of the assets.

As supervision of institutions becomes more centralized, institutions are no longer held accountable to local supervisors. Supervision that is centralized in Washington, D.C. is less connected to local communities and fails to involve local regulatory agencies adequately.

State supervision and regulation are essential to our decentralized and diverse banking system. State bank examiners are often the first to identify and address economic problems, including cases of consumer abuse. We are the first responders to almost any problem in the financial system, from downturns in local industry or real estate markets to the emergence of scams that prey on senior citizens. The states can and do respond to these problems much more quickly than the federal government.

Massachusetts has a long history of consumer protection. I have attached, as Exhibit A, a list of Massachusetts Consumer Protection Statutes. The federal Truth in Lending Act was modeled after the Massachusetts Truth in Lending Act. Through the express exemption provisions of the federal Truth in Lending Act, Massachusetts has had an exemption from Truth in Lending and its implementing regulations at Regulation Z for more than 30 years. The exemption provisions of the federal Truth in Lending Act and several other consumer protection laws allow for a State exemption if the State can demonstrate that its laws are as protective or are more protective than the federal law, and that the State has adequate enforcement authority and resources. Many laws in Massachusetts are actually more protective to consumers than their parallel federal counterparts, including the Massachusetts Community Reinvestment Act, the Equal Credit Opportunity Act, the Electronic Fund Transfers Act, and the Truth in Savings Act. I believe that the strength of Division's statutory authority is more than adequate to examine for not only all State consumer protection laws, but also all federal consumer protection laws applicable to the conduct of the business of each institution under our supervision.

Massachusetts also has a very active examination and enforcement program. Last year, the Division conducted more than 100 Consumer Compliance and Community

Reinvestment Act examinations of banks and credit unions. The Division also conducted more than 400 examinations of mortgage lenders and mortgage brokers for financial safety and soundness and for compliance with consumer protection laws and regulations. As a result of its examinations, the Division issued more than 100 enforcement actions against mortgage lenders and brokers, banks, and credit unions.

The Division has had long-standing productive and cooperative relationships with the federal regulators of Massachusetts-chartered banks and credit unions. In addition to existing safety and soundness programs, more than 10 years ago, the Division signed its first cooperative agreement with the Federal Deposit Insurance Corporation (FDIC) to ensure a coordinated approach to our respective CRA and Consumer Compliance examination programs. This agreement provided for an alternating examination program to avoid duplication or overlap of examinations. This agreement with the FDIC was followed by a similar agreement with the Federal Reserve Bank of Boston. These agreements have served our agencies and the banks in Massachusetts well.

As noted above, Riegle-Neal clearly stated that State branching, community reinvestment act, fair lending, and consumer protection laws apply to branches of out-of-state national banks to the same extent as a branch of a bank chartered by a host state. As I have stated, Massachusetts has an abundance of consumer protection laws, including fair lending and community reinvestment statutes. Over the years, several provisions of Massachusetts law have been preempted by the courts. However, the Division is not aware of any Massachusetts consumer protection law that has been specifically preempted by the OCC. In the case of CRA, the OCC has expressly acknowledged the laws of Massachusetts as well as those of Connecticut, New York, Rhode Island, Washington,

West Virginia, and the District of Columbia. In OCC Advisory Letter 98-17 and then in Advisory Letter 99-1, the OCC stated these states' CRA laws apply to host state branches of national banks. Advisory Letter 99-1 states:

> Since no issues have been raised with the OCC as to whether those laws would be preempted by any federal law, during our CRA evaluations of national banks, the OCC will solicit input from local banking commissioners regarding the banks' record of performance under applicable state community reinvestment laws. The OCC will contact local banking commissioners for the District of Columbia and the states that have passed their own community reinvestment laws to inform them that the OCC is scheduled to conduct CRA examinations. These contacts will coincide with the quarterly publication of the schedule of planned CRA examinations as prescribed by 12 CFR 25.45.

As you can well imagine, several large out-of-state national banks have branches operating in Massachusetts. Notwithstanding this OCC Advisory Letter, I am not aware of any communication at any time by the OCC relative to seeking input from the Division on these banks' compliance with the Massachusetts Community Reinvestment Act. Given the exclusive visitorial powers of the OCC, the Division is unable to determine either whether out-of-state national banks operating in Massachusetts are in compliance with Massachusetts CRA, fair lending, and consumer protection laws, or whether the OCC is fulfilling its mandate to examine for compliance with these provisions.

CSBS believes the process of routine examinations of financial institutions is critical to consumer protection. The importance of examinations should not be

underestimated; through this process, our examiners often uncover and address violations of consumer protection laws before large segments of the population are affected.

And while our supervisory system has evolved to accommodate the largest institutions that operate nationwide, the system must continue to evolve to ease the regulatory burden upon all financial institutions. This evolution, however, absolutely must not come at the expense of consumers, our ability to maintain and develop innovative and adequate regulations that protect consumers, or our ability to foster community banking. Through OCC, OTS and NCUA preemption of state laws, the financial system has been robbed of meaningful consumer protections. If Congress deems it appropriate to move towards a national consumer protection standard, then we ask that the nationwide standard grant enforcement authority at the state level.

The Dual Banking System

The United States boasts one of the most powerful and dynamic economies in the world. What sets the U.S. financial system apart from the rest of the industrialized countries is a broad-based and diverse banking industry marked by a meaningful choice in charters. Choice enables economic opportunity as well as a healthy dynamic tension among regulators, resulting in a wider range of products and services for business and consumers, along with lower regulatory costs and more effective, responsive supervision. In short, the U.S. economy flourishes because of our unique dual banking system, not in spite of it.

The dual banking system is a unique and historic characteristic of our nation. State bank supervision in the United States has been in existence since the late 1700s. My home

state of Massachusetts chartered its first bank, the Bank of Massachusetts, in 1784. The charter was signed by Governor John Hancock and Senate President Sam Adams. In 1863, Congress passed the National Bank Act, which created the national bank charter. Since the creation of our dual banking system with the passage of the National Bank Act, all banks, regardless of their charter, have been subject to a combination of federal and state laws. The balance of state and federal authority has evolved, shaped by new federal and state statutes and by a growing body of case law.

State supervisors work closely with the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve to ensure consumer protections. In addition, state Attorneys General provide independent consumer protection and enforcement oversight with respect to all state-chartered providers of financial services. These checks and balances tend to serve the public interest by keeping the focus on consumer protection along with safety and soundness concerns. Currently, however, no system of checks and balances exists for consumer protection under the federal charter. The Federal Trade Commission is specifically barred under 12 U.S.C. 45(a)(2) from bringing claims for unfair and deceptive acts and practices against banks or thrifts. In *Clearing House Ass'n v. Spitzer*, a case currently pending before the Second Circuit Court of Appeals, the OCC has asserted that its regulations preempt the authority of New York's Attorney General to bring a judicial proceeding against national banks or their operating subsidiaries in order to enforce New York's fair lending laws. Even though the OCC has conceded that the New York laws in question apply to national banks, the OCC has claimed exclusive authority to enforce such laws. Consolidating supervision and consumer protection in a single agency does not serve the public's interest.

The Evolution of the Financial Industry

In the years since the passage of the Riegle-Neal Act, the financial services industry has been transformed. Banks have taken advantage of their new powers under Riegle-Neal and Gramm-Leach-Bliley to offer their customers an unprecedented range of new products and services. Consistent with the states' role as the laboratory of financial innovation, many of these products and services originated at the state level. Yet as these new products and services have emerged, so too have new opportunities for consumer confusion and, in some cases, abuse.

The residential mortgage industry provides a useful case study to represent this explosion of product and service choice, with the side effects of consumer confusion and abuse. The rapid evolution of the mortgage industry created a new class of mortgage providers for borrowers, and in some cases these providers engaged in predatory and fraudulent practices.

The actions taken by the states in response to the evolving mortgage market have focused on protecting consumers through development and licensing and supervision of mortgage brokers and lenders, legislation, and enforcement of consumer protection laws. Each day state regulators take enforcement actions against mortgage lenders and brokers for abusive lending. In 2006 alone, states took 3,694 enforcement actions against mortgage lenders and brokers.[3] CSBS has also partnered with the American Association of Residential Mortgage Regulators (AARMR) to develop a nationwide mortgage licensing system to improve the efficiency and effectiveness of the U.S. mortgage market,

[3] Source: Mortgage Asset Research Institute.

to fight fraud and predatory lending, to increase accountability among mortgage professionals, and to unify and streamline state licensing processes. To my knowledge, no other regulator is developing or even contemplating such a system.

Our experience in this area shows that state financial regulation is a vital and essential dynamic for promoting new financial services while offering new approaches for consumer protection. The OCC has short-circuited this dynamic with the sweeping preemption of state laws that "condition" the activities of the institutions they supervise. States continue to seek new ways to protect their citizens, but preemption makes most of these efforts ineffectual, because the laws do not apply to the customers of most of the nation's largest institutions, which control the vast majority of the assets in the industry.

Given the OCC's broad preemption rules and the 5-3 decision of the Supreme Court, new consumer protection laws governing these institutions would have to originate at the federal level. As you know, enacting federal legislation is a long and cumbersome process, and federal laws address problems with broad strokes that may not be appropriate for both large and small institutions. The state system is much better equipped to respond quickly, and to tailor solutions to the specific needs of various communities and industry sectors. With limited resources at both federal and state levels, I believe we should be discussing sharing responsibilities among the state and federal regulators, not preempting valuable resources.

Watters v. Wachovia

Understandably, my fellow state bank supervisors and I are disappointed with the outcome of the *Watters* case. We do not believe that the Supreme Court will take up

another banking law case that would disturb the precedent set by the *Watters* case, but we do believe that the *Watters* case begs a variety of questions that will need to be interpreted by the state and federal regulators and possibly distinguished away by the lower courts. For example:

- What does it mean for the OCC to have an operating subsidiary regulation that the Court did not rely upon in reaching its decision that national banks can create operating subsidiaries? The Court gave no judicial deference to the OCC's regulation, so the regulation was neither upheld nor struck down. The Court had to go back to the 1864 Congress for support of its position under the National Bank Act.
- What does it mean to have an operating subsidiary that is anything other than a nondepository corporate entity? The Court said that operating subs derive their power from the national bank parent entity, but what about thrifts that are operating subs of national banks? What about state banks / ILCs / trust companies that are operating subs of national banks? These operating subs are financial institutions that are separately chartered and derive their powers from a source other than the national bank.
- What does it mean that preemption follows the activity, rather than the corporate structure of the bank? Does that mean that agents of the institution are also free to operate outside of the scope of state law and enforcement?

Given how important consumer protection is in today's financial marketplace, we are encouraged by the Committee's interest in reviewing ways to improve federal

consumer protection in financial services. In addition to its oversight of federal agency administration under present laws, Congress has its critical legislative role. When legislating, we strongly urge the Congress to retain and expressly build upon the presumption against the preemption of state law. Additionally, we strongly urge the Congress to include a clear statement if it intends to preempt state law in a particular area, or alternatively to provide an equally clear statement if Congress intends to direct a federal bank regulator to issue regulations that will preempt state law. One of the compelling points made by the dissenting justices in the *Watters* case is that the Congress is uniquely qualified to consider, evaluate, and accept or reject interests of the states in fashioning federal legislation; by contrast, the federal administrative agencies are inherently limited by their institutional role and mission, and can never be expected to consider the states' interest fairly in any agency action that might preempt state law.

The Supreme Court has spoken, but we ask Congress to consider restoring the balance of the dual banking system and to provide clarity on what state laws are preempted. We also believe that the Supreme Court has written a decision which encourages Congress to provide explicit scenarios when it intends to preempt state banking law or at least to prompt the OCC to provide more clarity as to which state laws it is enforcing as it is required to do under the statutory language of Riegle-Neal. Most importantly, we are troubled, as were the dissenting justices in the *Watters* case, that the Supreme Court's opinion made short shrift of the traditional consumer protection role played by the states.

Cooperative Role for the States

For close to 150 years, Congress has been careful to balance the interests of local government with the interests of a nationwide banking system. In enacting new banking laws, Congress has consistently paid deference to state laws in general and to consumer protection laws in particular. CSBS supports nationwide banking. We support interstate operations and the ability of customers to move and travel with their financial institutions, and we have worked hard to create a structure that facilitates interstate branching. We support competition in the marketplace and meaningful choice for both customers and financial institutions. We constantly seek opportunities to decrease regulatory burden and help our financial institutions develop more efficient operating systems. But this efficiency cannot come at the expense of the consumer, or at a competitive disadvantage to the thousands of community-based institutions that serve these consumers.

CSBS believes that effective supervision of the financial marketplace requires a coordinated effort among the federal agencies and the states. Ultimately, the goal for Congress and regulators should be to create an efficient supervisory structure that allows institutions to compete effectively and make their products and services available to a broad demographic, while offering effective consumer protection and recourse against fraudulent and abusive practices. If necessary, Congress should preempt state laws in an effort to achieve this goal of seamless supervision, not in an attempt to make the federal charter a more attractive option for financial institutions. CSBS is not against preemption in all cases. In fact, CSBS supports Congressional preemption in some areas, most notably with regards to the Fair Credit Reporting Act.

Recently the states, through CSBS, agreed to a framework for the sharing of consumer complaints and resolutions between the state agency and the OCC. The CSBS board of directors recently agreed to negotiate a similar arrangement with the Office of Thrift Supervision (OTS). CSBS and OCC are also working with the other agencies to develop a model consumer complaint form. These are all positive steps to improve service to consumers.

However, we believe the system has benefited from the states establishing expectations for consumer protection through laws, regulations and enforcement. Therefore, I am pleased to represent the State Liaison Committee on the FFIEC. As the newest voting member of the FFIEC, it is my responsibility to ensure that the states have meaningful input in the development of regulatory policy, regulation, and guidance. We are waiting for the federal agencies to complete their legal review and update the necessary operating agreements of the FFIEC to fully implement our role. While some believe this state-federal coordination is new, we have been coordinating quite well in supervision and enforcement over the last 10 years under the Nationwide Cooperative Agreement, signed by each state, the FDIC and the Federal Reserve. We can bring the same level of cooperation to the development of regulatory policy.

Congress created the FFIEC as an interagency body to promote uniformity and consistency in the supervision of financial institutions. With greater representation from state supervisors, we believe the FFIEC is the most suitable mechanism for the development of consumer protection standards going forward. While some of my colleagues may refer to an "interagency initiative," I would assert that the FFIEC is the method of interagency coordination that Congress intended. It is my belief that

institutions, consumers, and the economy as a whole will be better served as the federal agencies and the states work more closely together to provide coordinated supervision.

Recommendations for Congress

The states have tried to create a seamless web of supervision for multi-state state chartered banks through cooperative agreements at both the state and federal levels. We have worked with our counterparts in the State Attorneys General on supervisory actions with great success. However, with the latest interpretations over applicable state laws and enforcement authority, our hands are tied. We have almost no jurisdiction over an ever-increasing share of the industry. Only Congress can change the laws that govern the largest portion of the industry. To this end, we suggest the following.

- Congress should make it clear that the FFIEC holds authority over the development of consumer protection standards for new federal consumer protection laws.
- The Unfair and Deceptive Acts and Practices Act is a valuable tool; and Congress should consider giving the FFIEC authority to determine and prohibit unfair and deceptive acts and practices under the law.
- Congress should consider creating a centralized system for the collection and distribution of consumer complaints to the appropriate regulator. An alternative would be requiring banks to disclose who their primary regulator is and how to address consumer complaints to that regulator.
- The Riegle-Neal Interstate Branching Act stated that the OCC shall enforce applicable state consumer protection laws. While we do not believe that

meant to the exclusion of the states, it does beg the question: What state consumer protection laws is the OCC enforcing? It would be helpful to banks and state regulators to know specifically which state consumer protection laws are being enforced and which have been preempted. While the OCC rules give guidance as to what would be preempted, it is not clear what they are enforcing, if anything.

- Congress needs to make it clear that some level of accountability exists at the state level for federally chartered institutions. States need to be able to enforce both state and federal laws when a financial institution's primary federal regulator is not protecting the citizens of the state. State legislators and Attorneys General need a clear statement of their roles in protecting the citizens of their states.
- Congress should review the provisions of Riegle-Neal that define applicable law for both state and federal institutions.
- Congress should encourage federal and state coordination to develop consistent interpretation and enforcement of applicable state laws.

Conclusion

Consumer protection in the financial services market is of the utmost importance to state supervisors. When a consumer has a complaint, we are often the first place they turn to for guidance or relief. In conjunction with our state legislatures, our federal regulatory counterparts and state Attorneys General, state bank supervisors have created a network of statutes, supervisory procedures, and enforcement capabilities that seek to protect

consumers, ensure institutional safety and soundness, and promote competition and success in the industry.

CSBS is disappointed by the Supreme Court's ruling in *Watters v. Wachovia* because we believe the decision fails to protect consumers adequately and does substantial damage to our invaluable dual banking system by reducing the viability of the state charter. Moving forward, we now look to Congress to provide clarity on the scope of the OCC's preemptive power. I urge Congress to look carefully at the adequacy of the OCC's consumer protection provisions and consider whatever actions may be necessary to clarify the interaction of state and federal laws, restore the balance of the dual banking system, and reassert its authority over federal banking policy.

The states, through CSBS and our involvement on the FFIEC, want to be part of the solution. We want to ensure that consumers are protected, regardless of the chartering agent of their financial institution. We want to ensure the viability of both the federal and state charter options to ensure a meaningful choice in charters and the success of our dual banking system, and of our economy as a whole. We look forward to working with Congress and the federal banking agencies to build a structure that facilitates nationwide banking without harming our consumers, our institutions, or our economy.

Thank you again for inviting me here today. I look forward to answering the Committee's questions.

Exhibit A: Massachusetts Consumer Protection Statutes

Licensing Statutes

- Chapter 93, sections 24 to 28 - Debt Collectors
  - Loan Servicers (Registration only)
- Chapter 140, sections 96 to 114A – Small Loan Companies (Includes Maximum Interest Rate limitations)
- Chapter 167F, section 4 – Check Sellers
- Chapter 169 – Foreign Transmittal Agencies
- Chapter 169A – Check Cashers
- Chapter 255B – Retail Installment Sales of Motor Vehicles (Includes Maximum Interest Rate limitations)
- Chapter 255C – Insurance Premium Financing (Includes Maximum Interest Rate limitations)
- Chapter 255D – Retail Installment Sales and Services (Includes Maximum Interest Rate limitations)
- Chapter 255E – Mortgage Lenders and Brokers

Mortgages – General Provisions

- Chapter 183, section 28C – Loan in Borrower's Interest, Suitability
- Chapter 183, section 54 – Discharge of Mortgages
- Chapter 183, section 54B – Execution of Mortgage Discharges and Related Instruments
- Chapter 183, section 54C – Recording a Discharge
- Chapter 183, section 54D – Payoff Statements
- Chapter 183, section 55 - Refusal to discharge and Filing a Substitute Affidavit
- Chapter 183, section 56 – Prepayment of Certain Mortgage Notes
  (Presumed to be Preempted by OCC and OTS opinion rulings)
- Chapter 183, section 59 – Late Charges
- Chapter 183, section 60 – Short-term or Balloon Mortgage Loans

- Chapter 183, section 61 – Payment of Interest on Tax Escrow Payments **(Pre-empted by Federal Law per Court Case)**
- Chapter 183, section 62 – Payment of Real Estate Taxes by Mortgagee
- Chapter 183, section 63 – Charging of Points and Fees in Certain Residential Mortgage Transactions
- Chapter 183, section 63A – Revision in Terms
- Chapter 183, section 63B – Good Funds at Closing
- Chapter 183, section 64 – Mortgage Discrimination on The Basis of Location of Property
- Chapter 183, section 65 – Evidence of Insurance Contracts on Mortgages
- Chapter 183, section 66 – Limiting the Amount of Fire Insurance for Certain Policies
- Chapter 183, section 67 – Reverse Mortgage Loans (See also Chapter 167E, section 7)
- Chapter 183, section 68 – Applicability of Provisions as to Sale of Insurance by Banks
- Chapter 184, section 17B – Applications for Residential Mortgage Loans

High Cost Loans

- Chapter 183C – Predatory Home Loan Practices

Consumer Loans – General Provisions

- Chapter 255, section 12C – Promissory Notes Executed in Sales of Consumer Goods Shall Not Be Negotiable Instruments; Exception
- Chapter 255, section 12F – Borrower's Defenses in Consumer Loan Transactions
- Chapter 255, section 12G – Limits on Loan Insurance Charges and Types of Insurance
- Chapter 255, section 12H – Charge Cards, Imposition of Late Charges, Notice and Assessment of Annual Fees
- Chapter 255, section 13I – Creditor's Repossession Rights
- Chapter 255, section 13J – Debtor's Rights in Repossession
- Chapter 255, section 13L – Prepayment Procedures

Unfair or Deceptive Practices

- Chapter 93A – Regulation of Business Practices for Protection of Consumers
- Chapter 167, sections 2A to 2G – Unfair or Deceptive Acts Involving Consumer Transactions by Banks

CRA

- Chapter 167, section 14 – Massachusetts Community Reinvestment Act

Equal Credit

- Chapter 151B – Unlawful Discrimination Because of Race, Color, Religion, National Origin, Ancestry, Sex, Sexual Orientation, Age or Handicap

Loan Review Boards

- Chapter 167, section 14A – Mortgage Review Boards
- Chapter 167, section 14C – Small Business Loan Review Boards

Truth in Lending

- Chapter 140D – Truth in Lending

Truth in Savings

- Chapter 140E – Truth in Savings

Open-End Credit

- Chapter 140, section 114B – Maximum Finance Charge for Open-End Credit
- Chapter 140, section 114C – Notice of Annual Fees and Rebate Provisions to Cardholders

Insurance Sales

- Chapter 167F, section 2A – Sale of Insurance by Banks

(Certain Provisions Pre-empted by Federal Law per Court Case)

EMBARGOED UNTIL DELIVERY

STATEMENT OF

SHEILA C. BAIR
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

on

IMPROVING FEDERAL CONSUMER PROTECTION IN FINANCIAL SERVICES

before the

FINANCIAL SERVICES COMMITTEE
U.S. HOUSE OF REPRESENTATIVES

June 13, 2007
2128 Rayburn House Office Building

Chairman Frank, Ranking Member Bachus and members of the Committee, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) regarding ways to improve federal consumer protection in financial services. The examination by the Committee of existing federal consumer protection safeguards is timely in light of recent regulatory and judicial decisions that have preempted state consumer protection laws for federally chartered financial institutions and their non-bank subsidiaries, as well as for out-of-state branches of state chartered banks through the operation of the Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994.

In recent years, the U.S. financial system has been the source of extraordinary economic innovation. New products and processes ranging from credit cards, to internet banking, to securitization have substantially altered the choices and opportunities available to consumers. In turn, these new financial tools have helped to support generally strong and stable U.S. economic growth over the past two decades.

While the impact of innovation in the financial system has generally been positive, not all consumers have benefited. Many of these changes have been accompanied by pitfalls for the financially unwary or unsophisticated. This has resulted in financial distress for a number of consumers and has highlighted the importance of having a state and federal legal framework that provides consumers with the information and tools necessary to protect against unfair or exploitive products and practices.

My testimony will discuss some of the broad changes to the financial system and the challenges they are creating for consumers. It also will discuss the current legal tools available to regulators and how they are used to protect consumers. Finally, my testimony will discuss reforms that would improve the ability of consumer protections to keep pace with innovation in the financial marketplace.

Developments in the Financial System

Advances in technology and changes in lending organization structure have resulted in financial products that are increasingly complex and marketed through increasingly sophisticated methods. The pace and complexity of these advances heighten the potential risk for consumer harm. Consumers today often face a bewildering array of choices, especially in the credit options available to them. For example, there are seemingly unlimited types of credit cards, each with its own particular terms and conditions. Consumers now have choices beyond the traditional fixed-rate mortgage that include adjustable rate or nontraditional products that are tied to a variety of amortization schedules and arcane index rates. In many cases, it is difficult even for sophisticated consumers to fully understand the costs associated with particular credit options or to compare alternative products.

Another significant development in banking has been the increasing impact of fees on the overall cost of financial products. For example, typical credit cards now include higher and more complex fees than they did in the past. As noted in a recent

study by the Government Accountability Office, "Controversy surrounds whether higher fees and other charges are commensurate with the risks that issuers face."[1] The application of over-limit fees illustrates this problem. While issuers typically do not reject cardholders' purchases during a sale authorization even if the transaction will put a cardholder over the card's credit limit, they will likely later assess the same cardholder with an over-limit fee and also may impose a higher interest rate.

Similarly, while depository institutions have paid overdrafts on a discretionary basis for many years, a substantial number of institutions now routinely provide fee-based overdraft protection programs to their customers rather than offering traditional overdraft programs, such as lines of credit or linked accounts. Fee-based overdraft protection programs typically charge customers at least $20 - $35 for each overdraft. Depending on the size of the overdraft and length of time for repayment, the effective annual percentage rate (APR) can exceed 1000 percent. When used to cover the occasional overdraft, these programs can be beneficial. However when used repeatedly as a source of credit, they are extremely high priced.

Although we do not have pure fee statistics available, trends in the growth of noninterest revenue[2] underscore the banking industry's increasing reliance on fee-based sources of income. Last year, insured institutions obtained 42.2 percent of their net operating revenue (net interest income plus total noninterest income) from noninterest income. Ten years ago, the share was 34.3 percent. Twenty years ago, it was 29.4

[1] U.S. Government Accountability Office (GAO), "Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," Report 06-929, October 11, 2006, p.30.
[2] In addition to fees, total noninterest income also contains gains on asset sales, as well as market-sensitive revenues such as trading gains and venture capital income.

percent. During the past 20 years, the average annual rate of growth in noninterest income for the industry has been 8.4 percent. During that same period, the average annual growth rate in net operating revenue has been 6.4 percent. The growth of fee income is not per se harmful and has helped keep banks strong in an era of narrow net interest margins. However, as noted below, fee structures are problematic if they are poorly disclosed or so complex that consumers are unable to understand them.

Another significant change in the financial system has been the increased participation by providers other than banks and thrift institutions. For example, one estimate shows that some 52 percent of subprime mortgage originations in 2005 were carried out by companies that were not subject to examinations by a federal supervisor.[3] There also has been dramatic growth in both transactions services and small denomination consumer loans outside of the banking system by firms commonly called "alternative financial services providers." These firms, which include pawn shops, rent-to-own-stores, check cashing firms, and payday lenders, tend to provide relatively high-cost financial services to people of modest means. While estimates vary, some place the transaction volume of alternative financial services providers at $250 billion annually.[4] These firms are regulated at the state level and are subject nationwide to widely varying degrees of regulation, supervision, and enforcement.

In addition, the proliferation of securitization as a funding method has moved large volumes of assets off of the balance sheets of federally-insured financial

[3] Lending Oversight: Regulators Scrutinized in Mortgage Meltdown – States, Federal Agencies Clashed on Subprimes as Market Ballooned." *The Wall Street Journal*, March 22, 2007.
[4] Brian Grow and Keith Epstein, "The Poverty Business: Inside U.S. Companies' Ambitious Drive to Extract More Profits From the Nation's Working Poor," Business Week, May 21, 2007. This article cited data from investment bank, Stephens, Inc.

institutions. Federally-insured financial institutions held only about 31 percent of 1-4 family mortgage loans outstanding as of first quarter 2007, with more than 57 percent of 1-4 family mortgage loans outstanding held by mortgage pools or other asset backed securities issuers.[5] Securitized asset pools also have become significant holders of non-mortgage consumer credit. Though their share was insignificant prior to the 1990's, pools of securitized assets held 27 percent of outstanding consumer credit at the end of 2006. The share of consumer credit outstanding held by federally-insured financial institutions peaked at about 70 percent in 1985, and steadily declined to about 44 percent by 2006. This change in the market landscape has created competitive challenges for banks and thrifts and supervisory challenges for financial regulators.

Innovation in the financial system also has been accompanied by an increase in debt loads among consumers. Over the last 20 years, the ratio of total household debt to disposable personal income has more than doubled, climbing to more than 125 percent. Much of the rise in household debt is due to mortgage obligations. Credit card lines also have been part of a trend of rising household debt in recent decades. Credit card debt grew from 2.7 percent of annual personal disposable income in 1980 to 9.2 percent in 2006. In recent years, many consumers may have been using home equity loans or cash-out mortgage refinancing to pay credit card balances. Mortgage debt grew from 66 percent of total household debt at the beginning of 1992 to 75 percent by the end of 2006. Although there is no available data showing the proportion of household debt outstanding that represents money owed to alternative financial services providers, transaction level data suggests that interest and fees paid to these firms are substantial.

[5] Flow of Funds, Federal Reserve Board of Governors.

The significant growth in debt loads for lower income consumers and for young people has been especially troubling. Many of these borrowers have accumulated debt obligations, often as a result of student loans or credit cards, that put their financial health at risk even though the economy as a whole has experienced years of positive economic growth. In addition, subprime borrowers spend nearly 37 percent of their after-tax income on mortgage payments and other costs of housing -- roughly 20 percentage points more than prime borrowers spend, and 10 percentage points more than subprime borrowers paid in 2000.[6] Data show that young adults today are more indebted than previous generations were at the same ages and appear less likely to make timely debt payments than other age groups. The average credit card debt held by young adults ages 18 to 24 and 25 to 34 grew by 22 percent and 47 percent, respectively, between 1989 and 2004.[7]

Developing Problems

As financial products and services become more varied and complex, disclosures do not always provide adequate consumer protection from confusion or abuse. In addition, increased use of fees and tiered or variable pricing by financial service providers make it more difficult for consumers to shop and compare the costs of financial products. Moreover, given that disclosures are sometimes written more to guard against liability rather than to inform, they may even do more to obscure important information

[6] Eduardo Porter and Vikas Bajaj, "Mortgage Trouble Clouds Homeownership Dream," *New York Times*, March 17, 2007.
[7] Demos, "Generation Debt: Student Loans, Credit Cards, and Their Consequences," Winter 2007.

rather than clarify it. A recent GAO Report found that credit card disclosures, "... were too complicated for many consumers to understand."[8] Features and requirements that produce frequent and excessive fees and penalties are not always apparent to borrowers.

In addition to the complexity of the underlying product, aggressive or misleading marketing can have a negative impact on the ability of borrowers to make informed credit decisions. Without complete and balanced information, consumers may not realize that they may be unlikely to afford the required monthly payments of credit products -- particularly when a loan includes an initial teaser interest rate that will expire.

While improvements in the ability of lenders to price for risk have permitted financial institutions to extend credit to borrowers who have not previously been able to access credit, such improvements also have created problems. The extension of credit to unsophisticated borrowers has created greater opportunities for abuse. These vulnerable consumers are more susceptible to sophisticated marketing that directs them to products that may not be the best for their needs -- or affordable in the long run. Risk-based pricing is not a substitute for appropriate underwriting that ensures borrowers receive products that they understand and can afford.

The growing reliance by consumers on non-bank providers also has generated problems by creating a non-level playing field between bank and non-bank providers. Many financial service providers operate outside the traditional regulated banking and financial systems, at times to the detriment of consumers.

[8] GAO, Credit Cards: Increased Complexity in Rates and Fees, p. 6.

For example, the recent guidance issued by the federal banking agencies establishing standards for non-traditional mortgages[9] does not apply to non-bank lenders, often leaving them free to continue to make loans that are not underwritten to the fully indexed rate or with appropriate disclosures. This creates a competitive disadvantage for banks that are subject to more stringent regulation and provides less protection for consumers.

Finally, recent judicial and regulatory decisions on the preemption of state consumer protection laws have frustrated state consumer protection efforts. In addition to the preemption of state laws as they apply to national banks, state law restrictions on interest rates and fees are generally preempted for state banks to the same extent that they are for national banks. With regard to other consumer protection laws, if the particular host state's laws do not apply to the interstate branches of national banks, then they also do not apply to the interstate branches of state banks.

Many states have proven to be innovative laboratories for the development of consumer protections in recent years. They have been especially active in efforts to address predatory mortgage lending, including provisions addressing loan flipping, prepayment penalties, the fiduciary obligations of mortgage brokers, and many other areas. Yet, other states, eager to attract or retain financial service providers, have an incentive to permit such providers to operate with fewer, if any, constraints. In addition, multi-state banks wanting to avoid variations in state requirements have an incentive to

[9] See *Interagency Guidance on Nontraditional Mortgage Product Risks*, 71 FR 58609 (October 4, 2006).

choose a national charter, thereby preempting many state requirements. Most significantly, the general provisions governing federal preemption do not require the preempting authority or jurisdiction to substitute comparable standards. In the worst case, strong state standards may be preempted even if no alternative federal or state standards are substituted.

Current Legal Authorities, Supervision, Enforcement and Other Activities

The FDIC ensures that the institutions it supervises comply with all major federal consumer protection laws. Some of the major statutes include the following:

- The Truth in Lending Act (TILA), which ensures that credit terms for both credit card and mortgage transactions are disclosed in a meaningful way so consumers can compare credit terms more readily and knowledgeably;
- The Home Ownership and Equity Protection Act (HOEPA), which amended TILA to provide additional protections for mortgage lending;
- The Federal Trade Commission Act (FTC Act),which prohibits unfair and deceptive acts or practices affecting commerce;
- The Equal Credit Opportunity Act (ECOA), which prohibits discrimination in any aspect of a credit transaction; and
- The Real Estate Settlement Procedures Act (RESPA), which governs information disclosures for the home buying process.

In addition, the FDIC ensures that banks under its supervision comply with other statutes such as those related to flood insurance, privacy, fair housing, community reinvestment, credit reporting, electronic funds transfers, and disclosures for saving accounts.

While the FDIC has authority to enforce all of these laws, its rulemaking authority under them varies. For example, the FDIC has rulemaking authority with respect to the

entities it supervises and many of their subsidiaries under the privacy provisions of the Gramm-Leach-Bliley-Act, although the agencies must "consult and coordinate" with one another.[10] On the other hand, under the FTC Act, the Federal Reserve Board (FRB) has sole authority to issue regulations applicable to banks regarding unfair or deceptive acts or practices, while the Office of Thrift Supervision (OTS) and the National Credit Union Administration (NCUA) have sole authority with regard to the institutions they supervise. As discussed in more detail later, the FTC Act does not give the FDIC authority to write rules that apply to the 5200 entities it supervises -- state nonmember banks – nor does it grant that authority to the OCC for their 1700 national banks..

Activities that are harmful to consumers also can raise safety and soundness concerns. In these cases, the FDIC and other banking agencies have broad statutory authority to issue rules and guidance to address safety and soundness issues that also protect consumers. For example, the federal banking agencies recently issued interagency guidance for the safe and sound underwriting of subprime and nontraditional mortgages that directed banks to underwrite these loans to the fully indexed rate to ensure that banks are not making loans with no real prospect of repayment. This addresses an issue of poor underwriting practices by banks while also protecting borrowers from receiving loans they cannot realistically afford. Similarly, the account management guidance issued by the federal banking agencies[11] was designed to ensure credit card accounts were managed in ways that protected banks from excessive levels of default

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[10] 15 USC 6804(a).

[11] See FDIC Financial Institution Letter 2-2003, "Account Management and Loss Allowance Guidance for Credit Card Lending" issued on January 8, 2003

while at the same time establishing minimum payments at levels that avoid creating a risk of negative amortization for credit card debtors.

Supervisory Activities

With a cadre of specialized compliance examiners, the FDIC regularly examines institutions to determine whether they are operating in compliance with consumer protection laws and regulations. Institutions that effectively manage their compliance responsibilities are examined less frequently than those that fail to do so. As part of this process, the FDIC reviews the degree to which an institution's board and management oversee compliance, and whether they have implemented effective policies and procedures, employee training programs, consumer complaint response programs, and audit processes. The depth of the review of compliance with specific consumer protection laws and regulations is tailored to the risk profile of the institution. As consumer protection risks increase, the focus of the FDIC's review expands. Compliance examinations also provide information regarding management's performance in addressing regulatory responsibilities, which can provide insight into safety and soundness concerns as well.

When FDIC examiners find either violations of law or other weaknesses in how institutions manage their consumer protection and compliance responsibilities, the next step is to require corrective action. Such action may require changes in the way that an institution does business as well as require restitution or reimbursement for consumers.

Moreover, the FDIC may require that an institution document its commitment to take remedial action through either informal or formal enforcement actions. Evidence of discrimination or other illegal credit practices also adversely affect the evaluation of an institution's performance under the Community Reinvestment Act.

Informal enforcement actions may include a resolution issued by the institution's board of directors or a Memorandum of Understanding (i.e., a written agreement with the FDIC). Since January 2002, the FDIC has required institutions to issue 259 board resolutions and sign 138 Memoranda of Understanding to address consumer protection issues.

In more serious situations, the FDIC takes formal enforcement actions against financial institutions and individuals. In addition to ordering compliance with consumer protection laws, these actions may seek restitution on behalf of consumers, assess civil money penalties, remove individuals from office, or prohibit individuals from participating in the affairs of any financial institution. Since January 2002, the FDIC has issued six "cease and desist" orders and 213 civil money penalties against institutions for violating consumer protection laws.

Complaint Resolution

The FDIC Consumer Response Center (CRC) provides a single point of contact for consumer complaints against institutions supervised by the FDIC. The FDIC website

provides a toll-free phone number for consumer complaints, as well as an online complaint form. The table below shows the volume of complaints about FDIC-supervised banks that the CRC has received over the past five years. Approximately 40 percent of complaints received about supervised institutions involve credit cards. The top issues involved in these complaints include billing disputes and error resolution, terms and conditions, and fees and service charges.

Consumer Complaints Addressed by the FDIC, 2002 - 2006						
Complaints:	**2002**	**2003**	**2004**	**2005**	**2006**	**Total**
FDIC Supervised Banks - Total	4,008	4,057	3,950	3,618	3,831	19,464
Referred Outside the FDIC	3,809	3,770	4,473	5,059	5,604	22,715
% of Total Referred Outside the FDIC	45%	47%	51%	57%	58%	52%
Credit Cards – FDIC Supervised Banks	2,184	2,073	1,608	1,241	1,318	8,424
Credit Card Complaints as % of Total for FDIC Supervised Banks	54%	51%	41%	34%	34%	43%
Residential Real Estate Loans	235	255	279	207	245	1,221
Residential RE Loans as % of Total for FDIC Supervised Banks	6%	6%	7%	6%	6%	6%
Installment Loans	173	184	252	209	166	984
Installment Loans as % of Total for FDIC Supervised Banks	4%	5%	6%	6%	4%	5%
Other	830	895	1,077	1,139	1,211	5,152
Total	8,408	8,026	8,802	8,904	9,648	43,788

When the FDIC receives a consumer complaint, specialists evaluate the complaint, log it, and track the complaint case on an automated system to ensure

appropriate follow up. The FDIC investigates each complaint with the financial institution involved and provides appropriate information to the consumer to respond to the problem.

Almost 60 percent of the complaints received by the FDIC in 2006 relate to institutions supervised by other federal and state regulators. When concerns are expressed about institutions beyond the FDIC's jurisdiction, the complaint is referred promptly and directly to the agency that has the authority to help. In an effort to further enhance the process, the FDIC is working with the other federal and state banking agencies to develop a common consumer complaint form. The form would ensure that each agency is collecting the same data in the same format and increase the effectiveness of interagency complaint communications and referrals.

In addition, consumer complaints and inquiries play an important role in the development of strong public policy. Resolving these matters helps the FDIC:

- Identify trends or problems that may affect consumer rights;
- Understand the public perception of consumer protection issues;
- Formulate policy that aids consumers; and
- Foster confidence in the banking system by educating consumers about the protection that they receive under law.

Consumer complaints also may signal management or structural deficiencies in financial institutions that are indicative of more systemic problems within an institution. For this reason, every FDIC compliance examination of a financial institution includes a review of complaints against the institution and their resolution.

Encouraging Alternatives to High Cost Small Dollar Credit

In addition to supervisory tools, the FDIC also has the power to create regulatory incentives for increased competition for underserved markets and products. One example is responsibly priced small dollar lending. Loans in small dollar amounts are in strong demand. The payday lending industry now generates more than $42 billion in loans per year.[12] Moreover, a substantial number of institutions now routinely provide fee-based overdraft protection programs to their customers.[13]

In response to this growth, the FDIC has issued guidance on both payday lending[14] and fee based overdraft protection programs,[15] two sources of small dollar lending, and is in the midst of gathering empirical data about the nature of overdraft protection programs and how they are used by customers. However, the larger issue is the lack of low cost alternatives for consumers. To address this concern, the FDIC is working closely with the industry and consumer groups to identify the best ways to expand the availability of affordable small dollar credit to customers. Over the past two

[12] See Stephens Inc., Payday Industry Report, March 27, 2007. The Stephens Inc. report also estimates that another $5.65B in payday loans were advanced by internet payday lenders.

[13] See "Banks: 'Protection' Racket," BusinessWeek Online, May 2, 2005, http://www.businessweek.com/magazine/content/05_18/b3931085_mz020.htm (30% of institutions provide overdraft protection); "Sizing NSF-Related Fees," by Bill Stoneman, *Banking Strategies*, January/February 2005 (2500 institutions, i.e., about 28%, provide overdraft protection) http://www.bai.org/bankingstrategies/2005-jan-feb/sizing/ Laura K. Thompson, "Lending Rule Won't Apply to Overdrafts," *American Banker*, May 28, 2004. (3000 institutions, i.e., about 33% provide overdraft protection) http://americanbanker.com/article.html?id=200405271P3U4RUD&from=washtegu

[14] Guidelines for Payday Lending, Federal Deposit Insurance Corporation, March 2, 2005.

[15] Joint Guidance on Overdraft Protection Programs, 70 FR 9127, February 24, 2005. Among other things, the guidance explains "best practices" for marketing these programs, monitoring customer usage, and communicating with consumers about overdraft protection. The guidance encourages institutions to monitor excessive usage and offer recurrent customers more affordable products.

years, the FDIC has held two conferences to discuss both the need for such products and ways that insured institutions can meet this need and achieve positive business benefits.

Institutions offering reasonably priced small dollar credit products that meet consumer needs can receive positive consideration under the Community Reinvestment Act. Next week, the FDIC will issue final guidelines that will further explain how affordable small dollar credit can be offered in a streamlined way that benefits both borrowers and financial institutions. In addition, the FDIC Board will consider a proposal to launch a two-year small dollar lending pilot project. This proposed project will evaluate the effectiveness of business models used by up to 40 banks that currently offer small dollar loans to their customers. Working with the bank trade associations, we have initially identified 28 banks interested in participating in this proposed project and the FDIC will be recruiting others over the next several months. Consistent with our guidelines, the FDIC anticipates that loan programs selected to participate in this proposed project will include reasonable interest rates below 36 percent APR, low origination fees and repayment periods longer than a single payroll cycle. The goal of this proposed project is to assist bankers by identifying and disseminating information on the most effective ways to offer affordable small-dollar loans to consumers. Not only will a successful small-dollar loan program achieve positive outcomes for banks, it will also encourage wealth-development through savings and reduce consumers' reliance on high-cost, non-bank service providers. It is my hope that, over the next few years, responsibly priced small dollar loans will become a staple offering among our nation's banks.

Needed Reforms

I support the operation of market forces; however, regulators need to set rules for market participation. Moreover, price competition does not work if consumers do not understand the true cost of financial products. Through appropriate rulemaking, regulators can establish consumer protections against abuses that are strong and consistent across industry and regulatory lines. In addition, there should be meaningful enforcement authority and sufficient resources devoted to that authority. To achieve these goals, I would recommend that Congress consider the following reforms:

- The creation of national standards for subprime mortgage lending by all lenders which could be done by statute or through HOEPA rulemaking;
- Expand rulemaking authority to all federal banking regulators to address unfair and deceptive practices;
- Permit state Attorneys General and supervisory authorities to enforce TILA and the FTC Act against non-bank financial providers; and
- Provide funding for "Teach the Teacher" programs to provide for more financial education in the public schools.

Creating National Standards for Mortgage Lending

In light of the existing patchwork of state laws, consistency in consumer protection standards applied for mortgage loans at the federal level has the potential to raise the bar for many institutions and reduce the incentives for regulatory arbitrage. In a recent speech to the Greenlining Institute, Chuck Prince of Citigroup noted that:

> This balkanization, this patchwork of regulatory framework, . . . creates the opportunity for regulatory arbitrage, . . . people will find out how to game the system, they find out how to get the capital, get to that prize of

> funding in the capital markets through the least possible regulatory oversight.[16]

National standards would address these concerns with regard to mortgage lending and can be achieved through rulemaking under HOEPA or, alternatively, passage of new statutory standards.

HOEPA Rulemaking

HOEPA was an amendment to TILA enacted in response to abusive lending practices in the home equity lending market. HOEPA contains specific statutory prohibitions that apply only to "high cost" home equity loans and refinance transactions, and not to purchase money loans. HOEPA defines these "high cost" loans in terms of threshold levels for interest rate, points, and fees. For these "high cost" loans, HOEPA bans some practices -- balloon payments, prepayment penalties and the extension of credit without consideration of a borrower's ability to repay.

In addition, HOEPA requires the FRB to promulgate rules prohibiting acts or practices with respect to any mortgage loan that it finds to be unfair, deceptive, or designed to evade the provisions of HOEPA, and acts or practices with respect to mortgage refinancings that it finds to be associated with abusive lending practices, or that are otherwise not in the interest of the borrower. These provisions apply to all mortgage lenders, not just banks. The FRB has sole rulemaking authority with respect to HOEPA.

[16] Speech by Chuck Prince, Chairman and CEO, Citigroup, to the Greenlining Institute, April 23, 2006.

A regulation under HOEPA would have several advantages over a statutory approach. Rulemaking can usually be completed faster than passage of legislation and can be changed more easily, making it potentially more flexible and more precisely targeted to specific practices. It also can benefit from the public comment process to assure technical fine tuning and the identification of unintended consequences. Many abuses might be more effectively addressed by regulation rather than statute, especially in areas such as misleading marketing, in which the manner and types of abuse frequently change.

By using its broader rulemaking authority, the FRB could address a wider range of transactions. A HOEPA rulemaking establishing national standards for mortgage lending should include the following elements:

- Underwriting at the fully indexed rate -- Standards should require underwriting based on the borrower's ability to repay the true cost of the loan, not payments based on an artificially low introductory rate. This requirement would go a long way toward helping borrowers avoid loans they cannot repay, and would improve the quality of lender portfolios and mortgage backed securities. It also would help balance the role of mortgage brokers by curtailing the incentives to steer customers to high cost products that they cannot afford;
- A presumption against affordability if the loan, including taxes and insurance, exceeds a debt to income ratio of 50 percent;
- A prohibition on stated income loans in the absence of strong mitigating factors;
- Restrictions on prepayment penalties beyond two years or three months before reset, whichever is earlier;
- Mandatory escrow of insurance and taxes;
- No advertising of a teaser rate without a fully indexed rate and 30-year baseline comparison in the marketing materials -- Standards should address misleading or

confusing marketing that prevents borrowers from properly evaluating loan products. The standards should require that marketing information for adjustable rate mortgages include a benchmark comparison of the rate and payment being offered by the same lender for a traditional 30-year fixed rate mortgage. The standards also should require that all rate and payment disclosure information include full disclosure of the borrower's monthly payment at the fully amortized, fully indexed rate, not just the teaser rate -- consistent with the approach of the guidance that the FDIC and other agencies have issued;[17] and

- A prohibition on the use of the term "fixed" for anything but permanent fixed rate loans.

A HOEPA regulation that includes these elements would establish strong national anti-predatory lending standards that would provide significantly enhanced protections for consumers. In addition, the rule under HOEPA could make clear that the standard for secondary market liability attaches only where the violation is apparent on the face of the loan documents.

The regulation also should address activities by entities that operate outside the supervision of the federal banking regulators or on a multi-state or nationwide basis. For example, mortgage brokers have been identified as playing a significant role in predatory mortgage lending problems.[18] Mortgage brokers are increasingly operating on a multistate or nationwide basis, making it difficult for any one state to effectively regulate the actions of a particular broker. A HOEPA rule could set standards that, as a practical matter, would be applicable to mortgage brokers. For example, it could require lenders to only do business with mortgage brokers that are licensed by a state. Such a rule would complement the efforts of the Conference of State Bank Supervisors to establish a

[17] Interagency Guidance on Nontraditional Mortgage Product Risks, 71 FR 58609 (October 4, 2006); Proposed Statement on Subprime Mortgage Lending, 72 FR 10533, March 8, 2007.
[18] Mortgage Loan Fraud, Financial Crimes Enforcement Network (November 2006) at 6, http://www.fincen.gov/MortgageLoanFraud.pdf; Predatory Lending Report, Department of Housing and Urban Development, Department of the Treasury (Report 3076, July 15, 2000), at 76, http://www.treas.gov/press/releases/reports/treasrpt.pdf

nationwide database identifying all licensed mortgage brokers -- a project which the FDIC supports -- and would provide an incentive for states to license individual brokers.

The FRB will hold a public hearing tomorrow on HOEPA. The FDIC supports the FRB's efforts and would welcome new rules against abusive subprime or predatory lending practices.

Statutory Standards

Although rulemaking under HOEPA has a number of advantages over a statutory approach to the establishment of anti-predatory mortgage lending standards, Congress alternatively could consider enacting federal legislation to set standards. A statutory approach could establish whatever legal standard Congress wants to set for mortgage lending and could apply it to any parties in the lending process that Congress feels should be covered. However, it is very difficult to legislate underwriting and it would probably take longer to pass a statute than to establish standards by regulation.

Similar to HOEPA rulemaking, a statutory approach to establishing national anti-predatory mortgage lending standards could draw from the 36 state anti-predatory mortgage laws currently in effect. This menu of state laws includes provisions addressing loan flipping, prepayment penalties, escrow of taxes and insurance, the fiduciary obligations of mortgage brokers, and many other areas. At its core, however, a statutory framework should address two important areas: (1) the ability of the borrower to

repay the loan; and (2) misleading marketing and disclosures that make it unnecessarily difficult for borrowers to fully understanding the terms of loan products.

Expand FTC Act Rulemaking Authority to Address Unfair and Deceptive Practices

Section 5 of the Federal Trade Commission Act (FTC Act) prohibits "unfair or deceptive acts or practices in or affecting commerce." It applies to all persons engaged in commerce, whether banks or non-banks, including mortgage lenders and credit card issuers. While the standards for deceptive and unfair are independent of each other,[19] the prohibition against these practices applies to all types of consumer lending, including mortgages and credit cards, and to every stage and activity, including product development, marketing, servicing, collections and the termination of the customer relationship.

Deception: A three-part test is used to determine whether a representation, omission, or practice is "deceptive."[20] First, the representation, omission, or practice must mislead or be likely to mislead the consumer. The entire advertisement, transaction, or course of dealing must be considered in determining whether a practice is misleading. Second, the consumer's interpretation of the representation, omission, or practice must be reasonable under the circumstances. The totality of the circumstances and the net impression that is made by the representation is evaluated in making this determination. If the representation or practice affects or is directed at a particular group, reasonableness

[19] Joint Federal Reserve Board and FDIC Guidance on Unfair or Deceptive Acts or Practices by State-Chartered Banks, March 11, 2004, http://www.fdic.gov/news/news/financial/2004/fil2604a.html
[20] Id.

is examined from the perspective of that group. Finally, the representation, omission, or practice must be material. The basic question is whether the act or practice is likely to affect the consumer's conduct or decision with regard to a product or service. If so, the practice is material, and consumer injury is likely because consumers are likely to have chosen differently but for the deception.

Unfairness: Under the FTC Act, an act or practice is "unfair" where it: (1) causes or is likely to cause substantial injury to consumers; (2) cannot be reasonably avoided by consumers; and (3) is not outweighed by countervailing benefits to consumers or to competition.[21] Where information is "minimally" disclosed to consumers, some courts have held that consumers can avoid injury by choosing another product or service.[22] This makes the second element hard to prove. With respect to the third element, lenders argue that providing credit is a benefit -- even if questions can be raised about a borrower's long term ability to repay it. Finally, it is generally accepted that public policy may be considered in the analysis of whether a particular act or practice is unfair, but public policy may not serve as the principal basis for an unfairness finding.[23] Taken together, these high thresholds mean that situations that meet the statutory definition of "unfair" are rare and, therefore, enforcement actions by all relevant agencies are also rare.

The FTC has express authority to issue regulations that define and ban unfair or deceptive acts or practices with respect to entities other than banks, savings and loan

[21] 15 USC §45(n).
[22] For example, *Orkin Exterminating Co., Inc. v. FTC*, 849 F.2d 1354, 1365 (11th Cir. 1988) (observing that "[c]onsumers may act to avoid injury before it occurs if they have reason to anticipate the impending harm and the means to avoid it, or they may seek to mitigate the damage afterward if they are aware of potential avenues toward that end").
[23] 15 USC § 45(n); FTC Policy Statement on Unfairness (December 17, 1980).

institutions, and federal credit unions.[24] Currently, the FRB has sole authority to issue regulations that prohibit banks from engaging in specific unfair or deceptive acts or practices.[25] The OTS and the NCUA have such rulemaking authority with regard to savings and loan institutions and federal credit unions, respectively.[26]

In order to further strengthen the use of the FTC Act's rulemaking provisions, the FDIC recommends that Congress consider granting Section 5 rulemaking authority to all federal banking regulators. By limiting FTC rulemaking authority to the FRB, OTS and NCUA, current law excludes participation by the primary federal supervisors of about 7,000 banks. Including the perspectives of the supervisor of some of the nation's largest banks and the perspectives of the supervisor of the largest number of banks, as well as the deposit insurer, would provide valuable input and expertise to the rulemaking process. As a practical matter, these rulemakings would be done on an interagency basis and would benefit from the input of all interested parties.

State Enforcement of Federal Consumer Protection Standards

While strengthening the authority of the FDIC and its sister agencies provides tools necessary to deal with federally insured financial institutions and some related entities, non-bank financial service providers are now a significant portion of the lending market. Currently, state Attorneys General may bring actions to enforce violations of the prohibitions against certain high cost mortgages under HOEPA. To enhance enforcement

[24] 15 USC § 57(a).
[25] Id. at § 57(f).
[26] Id.

of federal consumer protection laws, Congress could consider expanding TILA as well as the FTC Act to allow state Attorneys General, state banking regulators, and other appropriate state authorities to bring actions against non-bank financial service providers under these laws. In general, state authorities currently operate under their own statutes that prohibit unfair and deceptive acts or practices, but may not have the full ability to enforce the federal standards. Expanding TILA and the FTC Act for non-bank financial service providers would give additional tools to state authorities, assist in maintaining minimum standards that apply to all financial service providers, and help provide a more level playing field for consumers and all lenders.

Financial Literacy

In addition to resolving consumer problems once they occur, the FDIC is committed to improving consumer knowledge and understanding of financial products. The FDIC considers financial education to be an essential component of our activities on vital issues facing consumers, markets and communities today. Not only is financial literacy essential to evaluate the multitude of choices available to consumers, but this knowledge serves to protect informed consumers from bad products and scams. A consumer who knows the right questions to ask, understands economic fundamentals and has the confidence to challenge products and practices that seem "too good to be true" is a regulator's best weapon in consumer protection.

While innovations in financial services have dramatically improved access to credit, this improved access has not always resulted in improvements in household welfare. Lack of adequate financial knowledge can lead consumers to make poor financial choices. Financially unsophisticated individuals may easily become targets of abusive lending practices. In addition to arming consumers with the ability to recognize the tradeoffs presented by products that may seem appealing at first glance, educating consumers about basic financial services helps them accumulate wealth, keep transaction costs down, comparison shop and secure access to credit.

As many on this committee know, the FDIC introduced a financial literacy program in 2001 called *Money Smart*. Over the past six years, this program has been used by 864,000 low- and moderate-income adults to enhance their money management skills. Available in six languages, large print and Braille, the program also helps these consumers understand basic financial services, avoid pitfalls, and build the confidence to use banking services effectively. To augment the *Money Smart* program, the FDIC has worked to establish partnerships with community and banker coalitions to blend a strong financial curriculum with service programs and proven asset building strategies.

Responsible and prudent financial practices should start early to teach good habits to young consumers. To this end, Congress may want to consider continued funding for programs that integrate financial literacy into school curricula such as the Excellence in Economic Education Program, authorized as part of the No Child Left Behind Act of

2001. This program is designed to provide resources for school systems to create curricula and provide teacher training for financial literacy programs.

The public schools are the best venue for reaching students of all income levels. Integrating financial education into core requirements such as math reduces the cost of providing separate financial education classes, which may be less effective, and assure students will be exposed to basic financial principles year after year. There are a number of excellent Teach the Teacher programs being provided by a growing number of education departments at major universities, but they could benefit greatly from federal financial support.

Conclusion

In conclusion, the U.S. financial system has undergone significant change and innovation in recent years. Although these new products and processes have increased the choices and opportunities available to consumers, they have also created financial pitfalls for the financially unsophisticated or the unwary. This has resulted in financial distress for a number of consumers and has highlighted the importance of having a state and federal legal framework that provides consumers with the information and tools necessary to protect against unfair or exploitive products and practices.

The FDIC considers consumer protection as an integral part of its mission. Working with our state counterparts, the FDIC regularly examines state-chartered

financial institutions for compliance with consumer protection laws and regulations. In addition, opportunities exist to improve and expand the ability of the federal banking agencies to protect consumers through the regulatory and legislative process. The recent judicial and regulatory decisions on preemption provide an opportunity for policymakers to reexamine the existing supervisory framework for consumer protection at the federal level. The FDIC stands willing to assist Congress and to join with our fellow regulators in exploring options to supervise a financial industry that is profitable for the institutions and fair to its customers.

This concludes my testimony. I would be happy to respond to any questions from the Committee.

For Release Upon Delivery
10:00 a.m., June 13, 2007

TESTIMONY OF

JOHN C. DUGAN

COMPTROLLER OF THE CURRENCY

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

OF THE

U.S. HOUSE OF REPRESENTATIVES

JUNE 13, 2007

Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

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INTRODUCTION

Chairman Frank, Ranking Member Bachus, and members of the Committee, I welcome this opportunity to appear before you today to discuss consumer protection issues in the banking industry. In your letter of invitation, the Committee expressed interest in various issues relating to the adequacy of current federal consumer protection rules, including the federal banking agencies' use of authority to combat unfair or deceptive financial trade practices; the effectiveness of existing consumer complaint resolution mechanisms; improvements that may be needed in both areas; and the role of state agencies in protecting financial consumers, particularly given recent developments concerning preemption of state laws.

I welcome this opportunity to describe all that the Office of the Comptroller of the Currency (OCC) does in this important area. The OCC takes its consumer protection responsibility very seriously. In recent years, retail banking has become an increasingly important component of national banks' activities and balance sheets; national banks have become much more important providers of consumer credit and other consumer financial services; and consumer financial products have become more diverse and complex. To address these developments, the OCC has increasingly focused on assuring fair treatment of national bank customers, and we have used all the tools at our disposal to do so.

Frankly, I believe our comprehensive approach to consumer protection is not well understood. The fact is, consumer protection is a fundamental part of our mission; we are not simply a safety and soundness regulator, as some have suggested. Accordingly, Part I of my testimony discusses our approach to consumer protection in some detail in order to provide a thorough description of what we do and how we do it. In particular, this part of the testimony describes the critical and unique role that our supervision plays in ensuring compliance with federal consumer protection standards. Our extensive and continual presence in national banks –

from large teams of resident examiners at our largest banks to our frequent on-site examinations of our community banks – allows us to identify and fix consumer compliance issues early and swiftly, before they become major problems.

Thus, ours is not an "enforcement-only" compliance regime – far better to describe our approach as "supervision first, enforcement if necessary," with supervision addressing so many problems early that enforcement often is not necessary. Indeed, given the effectiveness of the supervisory process, the number of formal enforcement actions taken by any bank supervisory agency is a misleading measure of the effectiveness of its consumer compliance regulation. Yet when we have needed to take strong enforcement action, the OCC has not hesitated, as our track record shows. And, as Part I further describes, our enforcement efforts have often been innovative, providing new precedents, standards, and legal theories to protect bank customers.

Finally, Part I concludes with a description of our robust process to address consumer complaints, including the new complaint sharing agreements we have signed with 18 states since November. It also discusses the OCC's planned launch, by the end of this summer, of a new consumer-focused internet site, www.helpwithmybank.gov. Among other things, a consumer having a problem with a financial institution will be able to access the site to obtain succinct and useful information about the institution's regulator and how to contact that regulator.

In short, we believe that the OCC's comprehensive approach to consumer protection regulation – integrating guidance, supervision, enforcement, and complaint resolution – is effective in achieving the objectives established by Congress. Nevertheless, as described in Part II, this approach has three significant, externally imposed limits: statutory limits, in that Congress has generally confined the scope of consumer protection regulation of banking activities to disclosure and the manner in which products and services are provided; rule-writing limits, in that the OCC has no authority to issue regulations to implement most of the important

consumer protection statutes that it is responsible for enforcing; and jurisdictional limits, in that the OCC's authority, obviously, extends only to national banks and their subsidiaries[1] and not to national bank competitors.

Part III addresses our view of the Supreme Court's recent decision concerning preemption of state laws in *Watters v. Wachovia Bank*[2] – what the decision does, and what it does not do. The decision does not mark a shift in the prevailing state of the law, but it does clarify accountability. In particular, it makes clear that federal and state regulators both have important, though different, jobs to do. For the OCC, we recognize the crucial responsibility we have to ensure that customers of national banks and their operating subsidiaries are not subjected to predatory, abusive, unfair, deceptive, or other illegal practices.

To assure appropriate treatment of all financial consumers, however, cooperation is vital between the OCC and the states. We should strive to optimize use of scarce resources – and maximize consumer protection benefits for all bank customers – by avoiding duplication of efforts and seeking to ensure that all market participants are subject to appropriate scrutiny.

The OCC is taking a number of steps to make that cooperation an ongoing reality. In addition to the MOU process already discussed for referring complaints, the OCC and the other federal banking agencies have cooperated with the states to extend the coverage of the nontraditional mortgage guidance and the proposed subprime lending guidance.

In addition, I am very pleased to announce today another cooperative initiative between the OCC and state bank supervisors, including my colleague Commissioner Antonakes: parallel

[1] In this testimony, the term "national bank" includes operating subsidiaries of national banks, because federal consumer protection standards apply to such operating subsidiaries in the same way as they apply to their parent banks, and the OCC regulates operating subsidiaries for these purposes in the same way as it regulates national banks.
[2] 550 U.S. ___, 127 S.Ct. 1559 (2007).

examinations involving national bank use of mortgage brokers, *i.e.*, instances in which national banks regulated exclusively by the OCC use independent mortgage brokers regulated exclusively by the states. This intersection of our regulatory jurisdictions provides a real and useful opportunity to coordinate our examination efforts – especially since there has been much criticism of the role played by mortgage brokers in mortgage markets around the country. Though still in the very early stages, I think both we and the Conference of State Bank Supervisors believe this new initiative shows real promise.

Finally, Part IV provides suggestions for improvement to federal consumer protection regulation, as the Committee requested. In particular, we suggest the need for joint agency authority to write regulations defining "unfair and deceptive practices" applicable to banking organizations. We also request that an agency charged with writing consumer protection regulations applicable to banks be required to consult, before issuing such regulations, with the regulators charged with implementing and enforcing them. In addition, we believe that consumer protection regulations should be revised and updated more regularly than they are now, in order for the regulations to keep pace with innovations and developments in retail banking. Finally, we propose that federal and state banking regulators, acting through the Federal Financial Institutions Examination Council (FFIEC), should jointly develop a centralized website for complaints by consumers of <u>any</u> banking institution, regardless of charter – if successful, such a website would provide real, tangible benefits to consumers.

I. THE OCC'S ROLE IN FEDERAL CONSUMER PROTECTION REGULATION OF BANKING ACTIVITIES

Banks are among the most extensively regulated commercial institutions in the United States. A key part of that regulation flows from the group of laws established by Congress that govern specific aspects of banks' interactions with consumers. These consumer protection laws apply to particular types of retail activities at all banks, including national banks, and often also

apply to nonbanks engaged in the same activities, such as mortgage lending. In general, the federal consumer protection laws applicable to banks are not intended to regulate product terms, or the rates and fees that are charged – as is the case, for example, with public utilities. Instead, markets are left to govern such activities, and federal consumer protection laws instead focus on the manner in which such products and services are provided in order to help ensure fair treatment of consumers.

When Congress enacted this group of banking consumer protection laws during the last 50 years, banks were already subject to an extensive regulatory and supervisory regime for safety and soundness. Thus, bank regulators were uniquely positioned to implement these new laws in ways that simply were not available with respect to unregulated providers of such financial products as consumer credit. As a result, in addition to providing the normal enforcement tools for implementing consumer protection requirements, Congress also charged the bank regulators with implementing these new laws through their well established supervisory and enforcement regime.

In this context, the OCC's comprehensive approach to consumer protection in the retail banking business of national banks integrates four related elements: 1) setting consumer protection standards, primarily through supervisory guidance; 2) comprehensive on-site supervision, to ensure compliance with federal laws and regulations and agency supervisory guidance; 3) enforcement, not just through formal enforcement actions applicable to all kinds of institutions, but also through informal enforcement actions applicable only to supervised banks; and 4) a state-of-the-art process for addressing consumer complaints. Each of these functions is discussed in more detail below.

A. Standard-Setting

As it must, consumer protection regulation begins with the generally applicable standards that govern particular activities. Federal consumer protection standards for banking activities have, in their broadest sense, been established by Congress in a wide array of federal statutes. In turn, these standards have been further articulated and refined in a multitude of federal regulations. To provide a concrete sense of the extent of these standards, the OCC's online Consumer Compliance Examination Handbook discusses approximately 30 federal laws and related implementing regulations.[3] For example, in the area of consumer credit alone, such laws include:

- The Home Ownership and Equity Protection Act of 1994 (HOEPA), which provides enhanced consumer protections with respect to certain high-cost mortgages and directs the Federal Reserve Board to issue regulations to address unfair, deceptive, abusive, and other problematic mortgage lending practices;[4]

- The Federal Trade Commission Act (FTC Act), which prohibits unfair or deceptive acts or practices and directs the Federal Reserve Board (with respect to banks), Office of Thrift Supervision (with respect to thrifts), and National Credit Union Administration (with respect to credit unions) to issue regulations defining such unfair or deceptive acts or practices and containing requirements prescribed for the purpose of preventing such acts or practices;[5]

- The Equal Credit Opportunity Act (ECOA), which prohibits discrimination against applicants based on race, color, religion, national origin, sex, marital status, age, the receipt of public assistance income, or the exercise of rights under the Consumer Credit Protection Act in any aspect of a credit transaction, and directs the Federal Reserve Board to prescribe regulations to carry out the purposes of the statute;[6]

- The Fair Housing Act (FHA), which prohibits discrimination based on race, color, religion, sex, handicap, familial status, or national origin in making a residential real estate-related transaction available, and authorizes the Secretary of Housing and Urban Development (HUD) to make rules to carry out the law;[7]

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[3] See http://www.occ.gov/handbook/compliance.htm.
[4] 15 U.S.C. § 1601 *et seq.*; *see also* 12 C.F.R. Part 226.
[5] 15 U.S.C. §§ 45, 57a(f)(1); *see also* 12 C.F.R. Part 227.
[6] 15 U.S.C. § 1691 *et seq.*; *see also* 12 C.F.R. Part 202.
[7] 42 U.S.C. § 3601 *et seq.*; *see also* 24 C.F.R. Part 100.

- The Truth in Lending Act (TILA), which requires creditors to provide disclosures about the terms and costs of credit, and directs the Federal Reserve Board to prescribe regulations to carry out the purposes of the law;[8] and

- The Real Estate Settlement Procedures Act (RESPA), which requires advance disclosure of settlement costs in residential real estate transactions and prohibits kickbacks or unearned fees for settlement services, and authorizes HUD to prescribe such rules as may be necessary to achieve the purposes of the law.[9]

As is indicated by this list, the OCC generally has not been provided the authority to write the regulations necessary to implement many of the most important federal consumer protection statutes, so our standard-setting role is not as broad as it is for other agencies, especially the Federal Reserve Board. There are some notable exceptions, such as in the area of consumer privacy, where the Gramm-Leach-Bliley Act charged all the financial institution regulatory agencies to issue consistent and comparable regulations that would be applicable to the institutions under their respective jurisdictions.

Despite this general lack of rule-writing authority, the OCC is responsible for ensuring that national banks comply with applicable federal consumer protection laws. This is not to say, however, that, with respect to these laws, the agency has no role in establishing or articulating standards that are generally applicable to national banks. To the contrary, like the other federal banking agencies, the OCC has used a supervisory tool to establish the agency's compliance expectations for national banks: supervisory guidance. Indeed, the OCC approach to consumer protection includes a prominent role for supervisory guidance to explain regulatory requirements. Such guidance also advises national banks on emerging and significant risks; on our expectations for bank practices for managing those risks and preventing problems from arising; and on likely areas of focus by bank examiners. The OCC's strategy is to prevent problems before they arise,

[8] 15 U.S.C. § 1601 *et seq.*; *see also* 12 C.F.R. Part 226.
[9] 12 U.S.C. § 2601 *et seq.*; *see also* 24 C.F.R. Part 3500.

and because we can issue supervisory guidance expeditiously, we can address issues quickly as they surface.

In this context, let me emphasize a point that is frequently misunderstood. In its usual form, OCC supervisory guidance is not merely a set of "suggestions" that national banks are free to ignore. Instead, guidance articulates principles with which we expect our banks to comply, and OCC examiners apply these principles in their ongoing bank supervision activities.

The OCC has issued supervisory guidance to national banks on a wide range of consumer protection matters, providing both general guidelines and more targeted directives when necessary to guard against specific practices. For example, a substantial amount of supervisory guidance has been directed toward ensuring that national banks do not engage in unfair or deceptive acts or practices within the meaning of the FTC Act. Perhaps most significantly, in 2002 we issued comprehensive guidance addressing the legal standards applicable to determining whether practices are unfair or deceptive.[10] This advisory letter also identified types of practices that may violate the FTC Act; stated our intention to enforce the law to address unfair and deceptive practices whether or not such practices have been specifically prohibited in rules issued by the Federal Reserve Board; and provided specific recommendations for avoiding unfair or deceptive practices and for mitigating compliance and reputation risks.[11]

Our supervisory guidance has also addressed a range of specific consumer protection issues, including credit card and mortgage lending practices, overdraft protection programs, payroll cards, gift cards, payday lending, and automobile title loans. With respect to credit cards,

[10] OCC Advisory Letter 2002-3 (Guidance on Unfair or Deceptive Acts or Practices), March 22, 2002.
[11] *See* Attachment A for a partial list of significant OCC supervisory guidance documents issued since 2000 focused on consumer protection issues. This list does not include numerous OCC and interagency issuances relating to privacy and information security matters. The OCC also has issued advisories directly to consumers on such subjects as gift cards and check processing (in addition to interagency brochures on a wider range of topics).

for example, we issued an advisory letter in April 2004 addressing secured credit card products, and we described the types of product terms and structures that appeared to raise such heightened compliance and other risks that they should not be offered by national banks.[12] Later, in September 2004, we released supervisory guidance concerning certain credit card marketing practices.[13] This advisory letter focused on ensuring that advertising text is not misleading, that limitations on the availability of a promotional rate offer are fully and prominently disclosed, and that there is full and prominent disclosure of the circumstances under which the interest rate, fees, or other terms of the card may change, including in connection with "universal default" and unilateral change-in-terms provisions.

Mortgage lending is another area in which we have issued detailed supervisory guidance. Two of our advisory letters from 2003 outline our expectations for conducting mortgage lending free from predatory or abusive characteristics. Among other things, these advisory letters provided detailed recommendations for establishing policies and procedures to help ensure that national banks do not become involved in predatory practices in any of their mortgage lending activities, including in loans made through brokers.[14]

In 2004, we also issued regulations (which in this case we had specific authority to do) prohibiting national banks from making loans based on liquidation of a borrower's collateral rather than the borrower's ability to repay.[15] And in 2005 we issued "Guidelines Establishing Standards for Residential Mortgage Lending Practices,"[16] based on the anti-predatory lending principles of our 2003 supervisory guidance. These formal Guidelines may be enforced under

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[12] OCC Advisory Letter 2004-4 (Secured Credit Cards), April 28, 2004.
[13] OCC Advisory Letter 2004-10 (Credit Card Practices), September 14, 2004.
[14] OCC Advisory Letter 2003-2 (Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices), February 21, 2003; and OCC Advisory Letter 2003-3 (Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans), February 21, 2003.
[15] 12 C.F.R. § 34.3. *See also* 12 C.F.R. § 7.4008 (establishing similar limitations on other lending activities by national banks).
[16] 12 C.F.R. Part 30, Appendix C.

provisions of the Federal Deposit Insurance Act (FDI Act). More recently, together with the other federal banking agencies, we have issued joint guidance on safety and soundness and consumer protection concerns presented by nontraditional mortgage products such as interest-only mortgages and payment option ARMs, and we have published proposed guidance relating to subprime mortgage lending.

B. Supervision

The primary method that federal banking agencies use to implement consumer protection standards is direct supervision – not formal enforcement actions – of the banks we supervise. As mentioned previously, this is a distinct and additional tool available to bank regulators that is generally not available for the regulation of nonbanks. Indeed, given our extensive presence in and supervision of the banks in our jurisdiction, we believe that supervision is by far the most effective means for achieving compliance with consumer protection standards.

This is not to say, however, that supervision is the only way that we ensure such compliance, or that we never resort to enforcement to achieve that result – quite the contrary, as our discussion of our enforcement program below makes clear. Instead, the fundamental point is that, when it comes to consumer compliance, banking regulators do not have an "enforcement-only" regime; instead, our regime is better described as "supervision first, enforcement if necessary." And supervision is such a powerful and effective tool that enforcement, especially in the form of formal enforcement actions, proves to be much less necessary than it is in "enforcement only" regimes.

Thus, the cornerstone of the OCC's approach to consumer protection compliance is comprehensive, ongoing supervision of national banks and their operating subsidiaries. The OCC extensively examines national banks to ensure that they are operating in a safe and sound manner and in accordance with applicable laws, regulations, and supervisory guidance –

including those relating to consumer protection. We supervise national banks by business line, so the standards applied in the course of our supervision are the same for national banks and their operating subsidiaries.

The scope and depth of our consumer protection supervision of national banks' operations is not well understood. This lack of understanding may result from the fact that the bank regulatory regime is different from other consumer protection regimes in which government actors must resort to publicized formal litigation or enforcement proceedings to effect desired changes. The critical point, often forgotten, is that, "behind the scenes" and without much public fanfare, bank supervision can result in significant reforms to bank practices and keep banks on a proper course – and it can do so much more quickly than litigation, formal enforcement actions, or other publicized events. As the Supreme Court recognized some years ago, "recommendations by the [federal bank supervisory] agencies concerning banking practices tend to be followed by bankers without the necessity of formal compliance proceedings." *United States v. Philadelphia Nat'l Bank,* 374 U.S. 321, 330 (1963). Of course, our broad range of potent enforcement tools, as well as the fact that we will not hesitate to use them if necessary, plainly helps make bank supervision a powerful and effective process for consumer protection.

So what exactly is this process? To begin with, retail banking supervision, including its consumer protection component, is a complex enterprise. We are long past the time when a "check the box" approach was adequate for consumer compliance supervision. Rather, effective supervision of retail banking activities today requires a sophisticated assessment of the bank's policies, operations, and controls, and of the long-term effect of those policies, operations, and controls on the bank's reputation, customer relationships, legal exposure, and earnings.

The OCC is unique among U.S. banking supervisors in placing large teams of resident examiners on the premises of each of the largest banking organizations we supervise. At some

of the largest institutions, the OCC has well over 50 examiners onsite on a continuous basis. This extensive on-site presence provides us with a heightened awareness of and insight into bank plans, practices, and potential problems with respect to consumer banking. Similarly, in our more than 1700 community banks, our regular exam cycle of 12 to 18 months, complemented by more frequent communications with bank management, always includes examination of the consumer compliance function – even though, as national bankers point out to us, our frequency of compliance review is not similarly required by a number of states with respect to their state-chartered banks.

The OCC also has networks of mortgage banking, retail credit, credit card, and compliance specialists located throughout the United States. The number of specialists has increased in the past ten years due to the significant growth and increased complexity of the retail banking business of national banks. The agency taps into this expertise for examinations in all parts of the country.

The time and attention devoted to the consumer lending and compliance activities of a national bank, large or small, is directly related to the nature and complexity of the bank's operations and associated risks. In the course of our ongoing supervision, OCC examiners review the adequacy of the bank's policies, systems, and controls relative to the character and complexity of the bank's business, and they evaluate whether the bank's activities comply with applicable consumer protection laws and regulations. Examiners typically sample individual loans or other transactions to validate their assessment of the bank's systems, controls, and legal compliance, and, depending on the circumstances, may target their reviews to a particular loan product, business line, or operating unit. If consumer protection issues surface in the course of these examinations, examiners assess whether the practices in question violate applicable

consumer protection laws or regulations, including the FTC Act, and whether they are consistent with OCC guidance and standards.

Throughout this process, examiners have access to nearly all types of management documents and reports, including policy and process changes, tracking reports, management self-assessments, and internal and external audit reports. Examiners independently review and evaluate performance, looking for potential compliance issues and other emerging risks. In the largest banks, compliance and consumer lending specialists meet frequently with key line-of-business, risk management, compliance, and audit personnel from the bank. Examiners discuss strategic initiatives, new product development, risk profiles, the status of major projects, and progress in addressing corrective actions for issues identified by bank management itself, auditors, or OCC examiners. Similar meetings occur with multiple levels of bank management, from business line managers to the most senior executives. OCC consumer lending and compliance specialists remain vigilant for potential consumer protection issues during these meetings and while reviewing reports. And the agency also uses so-called "target reviews" for more in-depth evaluations of an area of a bank's operations.

OCC examiners are often able to address potential consumer protection and safety and soundness issues proactively with management through this ongoing supervision process. As an example, bank management often will consult with examiners if they have questions about regulatory issues as they consider new processes or products. Similarly, management may identify potential problems in existing products or practices and consult with examiners about appropriate corrective actions that the bank should undertake. In addition, as described in more detail below, consumer complaints are used by examiners to address emerging consumer protection issues. And examiners also hold discussions with bank management to discuss significant litigation against the bank that may involve consumer protection matters. In all these

ways, examiners can identify and deal with many issues in a timely manner and address them before they develop into major problems.

Of course, communication plays an essential role throughout the supervisory process, whether through formal and informal meetings or examination reports and other written documents. The written materials detail findings from our ongoing supervision and target reviews. Violations of law or regulation, non-conformity with supervisory guidance, and other significant problems can be addressed in a variety of ways, including as findings and conclusions in written reports of examination, especially "Matters Requiring Attention" (MRAs) directed to the bank's Board of Directors. OCC examiners expect prompt corrective measures to be taken with respect to consumer protection matters when they are identified. Failure by bank management to do so will contribute to a conclusion that additional steps, including formal enforcement action, are required.

In sum, the OCC's supervision of the retail banking operations of national banks, including the consumer protection issues raised by those operations, is rigorous and comprehensive. We devote substantial resources to this area, and we are proud of the quality of the work that we do to oversee the retail banking business conducted by national banks and their interactions with their customers. Because we are not an "enforcement-only" regime, we expect most problems to be resolved through the supervisory process – and they are. Nevertheless, those who assert that the OCC is not committed to this area, or lacks the resources to handle it, or cares only about safety and soundness, are quite simply wrong.

C. Enforcement

When the normal supervisory process is not sufficient to result in bank compliance with consumer protection standards, the OCC, like the other bank regulatory agencies, has a spectrum of potent enforcement tools to address violations of law or regulation, non-conformity with

supervisory guidance, and other significant compliance problems. For the less serious of these problems, the OCC begins at one end of this enforcement spectrum – not with the type of formal and public enforcement actions that are widely reported, but instead with informal enforcement actions. In ascending order of severity, informal enforcement actions can take the form of a supervisory letter, memorandum of understanding, or a so-called "Part 30 compliance plan." Banks take these informal enforcement actions very seriously, because they are rightly perceived as a serious indication that there is a problem that needs the bank's immediate attention to fix – with formal action to follow if they do not. Such actions frequently involve specific and detailed steps that the bank must take before "the document" is removed. And the imposition of such documents can sometimes impair the bank's ability to expand through acquisitions until the underlying problem is addressed – a condition that always obtains management's full attention. In the OCC's experience, national banks go to great lengths to take the corrective steps necessary to address informal enforcement actions involving consumer protection issues.

But that is not always true, and in other circumstances, the underlying problem is so severe that informal enforcement action is inadequate. In such cases, the OCC can and will take formal enforcement action, as our track record clearly demonstrates.

Congress has provided the federal banking agencies with broad authority to take such formal actions. Section 8 of the FDI Act gives the agencies power to compel compliance with any law, rule, or regulation applicable to banks, including TILA, HOEPA, FHA, ECOA, RESPA, and the FTC Act – the principal federal statutes that provide protections for consumer credit applicants and borrowers. For example, this authority allows the OCC to require national banks to: (1) enter formal written agreements not to engage in particular activities that violate consumer protection laws; (2) cease and desist from engaging in such activities; (3) provide

restitution for affected consumers in appropriate cases; and/or (4) pay civil money penalties.[17] Since 2002, the OCC has taken over 100 formal enforcement actions relating to consumer protection issues. These include actions to address RESPA violations, TILA violations, violations of flood insurance requirements, and deficiencies in information security programs. In connection with these actions, we required national banks to, among other things, cease making payday loans and improve internal controls regarding consumer compliance and information security.

In addition to cases based on the specific requirements of applicable consumer protection laws and regulations, the OCC also has the authority to bring enforcement actions when it determines that a national bank has engaged in unfair or deceptive practices within the meaning of the FTC Act. Indeed, the OCC was the first federal banking agency to take enforcement action based on this authority. In a groundbreaking case in 2000, the OCC asserted section 5 of the FTC Act – together with our general enforcement authority under the FDI Act – as a basis for seeking a cease and desist order, as well as affirmative remedies, against a national bank. Use of this authority led to a consent order that required the bank to provide at least $300 million to consumers in restitution for deceptive marketing of credit cards and ancillary products; to cease engaging in misleading and deceptive marketing practices; and to take appropriate measures to prevent such practices in the future, including the modification of its policies and telemarketing scripts to ensure the accurate disclosure of all fees, charges, and product limitations before a consumer purchases a product. This use of the FTC Act was initially greeted with substantial skepticism – even by our fellow regulators – but the OCC believed it was both necessary and

[17] 12 U.S.C. § 1818. This statute also permits the OCC to pursue remedies based on unsafe or unsound banking practices.

lawful to address practices that the agency concluded were unfair or deceptive to consumers. This enforcement position has since been adopted by all the federal banking agencies.

Since that time, the OCC has taken nine additional formal enforcement actions against national banks or their operating subsidiaries based on the FTC Act's prohibition against unfair or deceptive practices.[18] These actions have involved issues ranging from misleading subprime credit card practices, to unfair product terms, to abusive mortgage practices. Contrary to some reports, these cases were focused on violation of this important consumer protection law, not on safety and soundness concerns, and the actions have been crafted to redress harm to consumers.

The OCC also was the first federal banking agency to use its enforcement authority to apply the FTC Act's prohibition against unfair or deceptive practices to predatory mortgage lending. While there is scant evidence of predatory lending in the national banking system, we will not hesitate to use our enforcement tools to combat abusive mortgage lending. To date, the OCC has brought two FTC Act cases against abusive mortgage lending practices. In a 2003 consent order, we required a bank to provide restitution to borrowers who were affected by unfair practices in connection with "tax lien" mortgage loans. In 2005, the OCC entered into a formal agreement requiring another bank to establish a $14 million fund to reimburse various categories of consumers harmed through their dealings with the bank's mortgage lending operating subsidiary.

In sum, the OCC has broad enforcement authority to achieve corrective action to ensure compliance with consumer protection laws, and we have not been hesitant to use it where required. As described above, however, it is misleading to focus only on enforcement actions – especially just formal and public enforcement actions – as the sole measure of bank regulators' effectiveness in achieving corrective actions at banks. Indeed, the type of corrective action that

[18] *See* Attachment B for a summary description of the OCC's enforcement actions based on the FTC Act.

can be achieved in the supervisory and informal enforcement process is often far broader than the corrective action that can be achieved in the formal enforcement process.

At the OCC, we employ all of the tools available to us – supervisory communication, informal enforcement actions, and formal enforcement actions – to address compliance violations; to combat abusive, predatory, unfair, or deceptive lending practices; and to require appropriate corrective action.

D. Complaints

In its letter of invitation, the Committee specifically requested information on consumer complaint processing. The OCC's Customer Assistance Group, or CAG, provides assistance to customers of national banks and their subsidiaries by fielding inquiries and complaints from or on behalf of consumers. CAG's complaint processing and analysis helps to redress individual problems and to educate consumers about their financial relationships. In addition, it frequently leads to compensation or other relief for customers who may not have a more convenient means for having their grievances addressed. CAG also supports our supervision of national banks' retail banking operations in several respects, as described below.

Our CAG function today integrates skilled professionals and effective use of up-to-date technology to address bank customer concerns, and our significant investment in the success of this operation has resulted in its becoming a recognized – and effective – leader among government complaint analysis and resolution functions.[19] CAG is staffed by customer assistance professionals who have backgrounds in consumer law, compliance, and bank supervision, and who can process written complaints and telephone calls in both English

[19] *See* "Remarks by John C. Dugan before the Exchequer Club and Women in Housing and Finance," (January 17, 2007) (discussing the sophisticated systems used by CAG in connection with the complaint resolution process).

and Spanish. Additionally, other OCC personnel, including attorneys in the Law Department, regularly assist CAG staff with more complex issues or problems to help ensure that complaints are resolved appropriately and, where applicable, that any identified violations of law are fully addressed.[20]

CAG receives approximately 70,000 inquiries and complaints each year on a multitude of consumer issues that are received through a variety of channels. Many of the inquiries and complaints are received directly from consumers, but there are numerous other sources as well, including Congress, other federal government agencies, state attorneys general, state banking departments, or other state agencies. For instance, CAG receives thousands of complaints each year referred from state entities.

When CAG receives a written complaint involving a national bank or national bank operating subsidiary, CAG contacts the national bank involved and requests a response regarding the consumer's complaint and, if relevant, supporting documentation. CAG evaluates the bank's response, consults with other OCC personnel in appropriate cases, requests additional information from the bank or consumer as necessary, reaches a final conclusion regarding the matter, and notifies the consumer or other complainant of its findings.

CAG staff is dedicated to its mission of satisfactorily addressing inquiries and resolving consumer complaints, and is persistent in its efforts to obtain fair treatment of national bank customers. This commitment is reflected in the results they have achieved. Over the last five years, CAG has generated almost $32 million in compensation for national bank customers, as well as other relief such as suspended foreclosure proceedings, corrected credit bureau reports, and reduced interest rates.

[20] Complaints that allege or raise issues of predatory lending or unfair or deceptive practices, for example, are generally reviewed by CAG personnel in close consultation with the OCC's Law Department.

In response to one issue in which the Committee has expressed a particular interest – and consistent with a recommendation by the Government Accountability Office – CAG conducted its first customer satisfaction survey last year. Although we are still carefully reviewing the comments and suggestions made by consumers, several results are evident. First, the public rated the initial point of contact at CAG higher than the government average. Second, as one would expect, those consumers who received the relief they requested reported high overall satisfaction with their CAG experience, while those who did not obtain their requested relief were less satisfied – and of course, CAG cannot always provide the relief requested by the consumer. In some instances, for example, the consumer may simply be dissatisfied with a provision in his or her contract with the bank in question. CAG will conduct follow-up surveys on a regular basis to identify trends and patterns in responses, and to assess the progress we are making in addressing consumer concerns.

Another issue in which the Committee expressed particular interest is how consumer complaints are taken into account as part of the examination process for any given institution. In fact, data derived from the CAG process plays an important role in identifying problems – at a particular bank or in a particular segment of the industry – that may warrant further investigation by examination teams, supervisory guidance to address emerging problems, or enforcement action. Indeed, OCC supervisory guidance requires examiners to consider consumer complaint information when assessing a bank's overall compliance risk and ratings, and when scoping and conducting examinations.

The CAG process thus has a direct impact on our bank supervision. The complaint data collected by CAG are summarized and distributed to OCC examiners to help them identify issues that warrant further review. Examiners have real-time access to an electronic database that stores consumer complaints and other relevant data for use in bank examinations. Examiners use

this information in assessing risks at the banks they examine, as well as in the process of planning, timing, and scoping examinations to target areas of potential concern. CAG specifically alerts examiners if the volume, patterns, or types of complaints concerning a particular bank appear to warrant immediate attention. Moreover, as discussed above, an important component of OCC supervision is the guidance we issue to alert national banks to emerging risk areas. CAG information has informed OCC policy personnel on the need for additional supervisory guidance, such as our guidance on credit card marketing practices and on gift cards.

OCC guidance also directs national banks themselves to monitor and address consumer complaints that they receive, whether from consumers directly or through CAG or other sources. To assist banks in addressing the underlying factors that may be contributing to consumer complaints, and to encourage them to do so, CAG provides aggregate feedback to banks on practices that, based on complaint volumes and trends, may need improvement. CAG regularly contacts banks that have large complaint volumes, both through informal telephone and e-mail exchanges and through annual meetings with bank management.

Finally, let me briefly mention three recent initiatives involving CAG that we believe will significantly improve the consumer complaint resolution process, not just for national banks, but for consumers at other banks as well.

First, as described in more detail below in the section of the testimony on OCC/State Cooperation, late last year the OCC executed a model Memorandum of Understanding with the Conference of State Bank Supervisors (CSBS) that is intended to facilitate the referral of complaints between the OCC and individual states, and to share information about the disposition of these complaints. We believe this process will result in much more timely handling of consumer complaints that are mistakenly filed with another agency.

Second, we have work underway to establish a secure, web-based technology platform to expedite complaint information sharing. The Complaint Referral Express will be a new application to facilitate the transfer of misdirected complaints and referrals between the OCC and other federal and state banking agencies. This project is currently in development, with testing anticipated early next year and full implementation planned by mid-year 2008. When this system is fully implemented, the end user agency – the one that will be handling the complaint – will be able to "pick up" the consumer's complaint information in a digital format and incorporate that information into the agency's own case management system. In addition, consistent with the information sharing agreements we have entered into with many state banking agencies, Complaint Referral Express will include a feature that provides the status and disposition of complaints referred to the OCC by the states.

Last but not least, I am very pleased to announce that the OCC will soon launch a new internet site called www.helpwithmybank.gov. As the Committee's letter of invitation implicitly recognizes, customers of financial institutions may not know which federal or state agency regulates their banks, or how to file a complaint or otherwise obtain assistance when they have a problem. We believe the new website – initiated, developed, and funded by the OCC – will be an important step to help address those issues. The site will include a wide variety of frequently-asked questions and answers; a reference tool that will assist consumers in determining which agency regulates their institution; and information on how to contact the various federal and state bank regulatory agencies. The English language version of this site should be operational this summer, and we plan to implement a Spanish language version next year.

We will continue to seek ways to use our CAG operations as a base from which to improve coordination on consumer complaints with our federal and state counterparts. In fact, we are hosting a meeting that will take place later today with the other banking agencies, the

CSBS, and the FTC to discuss development of a uniform consumer complaint form that would be used by consumers to file complaints with federal and state authorities. We also will be exploring these issues with those counterparts later this year, at an interagency forum on consumer complaint processing organized by the OCC.

II. LIMITS ON OCC'S ROLE IN CONSUMER PROTECTION

We believe that the OCC's integrated approach – incorporating standard-setting, supervision, enforcement, and the consumer complaint function – has proven to be an effective way to implement the consumer protection responsibilities that Congress has assigned to us. Nevertheless, there are three externally imposed limits on the OCC's consumer protection role that are important to understand as the Committee weighs additional actions in this area: statutory limits; rule-writing limits; and jurisdictional limits.

A. Statutory Limits

As discussed at the outset, Congress has generally not attempted to address consumer protection by regulating product terms or rates and fees – or indeed, by going beyond disclosure regulation in most instances. Thus, while some may argue that "penalty" credit card interest rates are excessive, or that so-called "2/28" subprime adjustable-rate mortgages should not be permissible, federal law does not impose a cap on permissible interest rates, and it does not generally prohibit particular mortgage features. As a result, the authority of the OCC and the other federal banking agencies to take action in such areas is circumscribed.

B. Rule-writing Limits

As described above, few consumer protection statutes authorize the OCC to issue implementing regulations, and that in turn limits our authority to establish prescriptive standards in interpreting such statutes. In many cases the apparent logic for this regime is to vest a single regulatory agency – often the Federal Reserve – with the authority to establish a single set of

rules applicable to all market participants, regardless of regulator. While that logic plainly has merit, it can also create anomalies. For example, the OCC supervises 75 percent of the credit card market, yet had no input into the recently proposed revision to Regulation Z covering credit card disclosures (other than a formal comment letter on the Advance Notice of Proposed Rulemaking that we submitted to the Federal Reserve in 2005). This is not a criticism of the content of that proposed revision, which the OCC generally supports, but rather an observation about the rulemaking process. Likewise, neither the OCC nor the FDIC has rule-writing authority to define unfair and deceptive practices under the FTC Act even though so much of the expansion in retail banking activities has occurred in the banks we supervise.

As described above, the OCC does have, and uses, its authority to issue supervisory guidance as a means to set some consumer protection standards for national banks – but such guidance does not (and should not) have the same force of law as a regulation. Guidance is simply not a vehicle for establishing *new* prohibitions or *new* legally binding constraints across an industry. OCC supervisory guidance in the consumer protection arena, for example, has alerted national banks to existing legal standards and emerging risks, and provided disclosure and other recommendations designed to address those risks. But it has not created new legally enforceable standards. Enforcement actions, similarly, do not – and cannot – create new legal standards that apply across-the-board to all national banks operating throughout the country with the force and effect of law.

The OCC has been successful in effecting changes in national bank policies and practices through supervisory actions where we believed such policies and practices were inconsistent with prudential or consumer protection standards or requirements that the OCC has been charged with implementing, including the FTC Act's prohibition on unfair or deceptive practices. However, when practices have not been restricted by Congress or existing rules – and in some

cases may even appear to be countenanced or endorsed by applicable federal laws and regulations, such as certain credit card billing practices – our ability to effect such changes is constrained.

C. Jurisdictional Limits

Obviously, the OCC's authority extends only to national banks. That fact can act as a practical constraint on what can be done in the area of consumer protection regulation, especially in the area of standard setting. For example, the OCC's recent effort to curtail prolonged negative amortization practices in the credit card market met strong resistance from national bankers who complained that non-national bank competitors may not be subject to the same stringent standards. We ultimately insisted on compliance notwithstanding this potential problem, but the differential regulation made the process more difficult and time-consuming, and similar issues have arisen in other areas.

We recognize that such potential regulatory differences can often be reduced through cooperation among federal regulators, and the agencies have worked together on a number of different regulatory projects to do just that. But it is not always possible to achieve consensus in a short period, and agencies that seek to "go it alone" will nearly always confront the "competitive unfairness" objection. Put another way, relying on OCC supervisory activities alone to effect needed changes across an industry confronts both practical limits and important fairness considerations.

A related limit arises from the increased participation of nonbank providers in markets for credit products and other traditional banking services. In such instances, the agreement of the federal banking agencies to pursue a unified position is not likely to be adequate to establish a uniform standard that is fair to all competitors, because such a standard would apply only to banking organizations and not to other providers of the same products. A standard with limited

applicability also would not provide comprehensive consumer protection. As described below, we confronted this issue both with the guidance for nontraditional mortgages and the proposed guidance for subprime mortgages. In both cases, huge parts of the market have been dominated by nonbank providers subject exclusively to state regulation. Federal regulators have attempted to address this issue by urging adoption of similar standards by each of the 50 states. While the states have made progress with this approach in both instances, it remains to be seen whether this will prove to be an effective way to establish and apply a national standard. These realities make plain the importance of coordinated interagency action – at the federal and state levels – to resolve appropriately the many consumer protection issues that cut across particular charter choices and the jurisdictions of particular agencies.

III. FEDERAL/STATE COORDINATION ON CONSUMER PROTECTION ISSUES

A. Preemption and the Impact of *Watters v. Wachovia Bank*

The Committee has also expressed an interest in the consumer protection role of the states, the impact of federal preemption of state laws on consumer protection, and the role that can be played by states working with federal regulators. We believe that there is much promise for enhanced federal/state cooperation and corresponding improvements in consumer protection, and that the recent decision of the Supreme Court in *Watters v. Wachovia Bank* does not undermine those opportunities.

In our view, the *Watters* decision does not mark a shift in the state of the law. Citing a number of its previous decisions, the Supreme Court in *Watters* reaffirmed that state law may not significantly burden, curtail, or hinder a national bank's efficient exercise of any of its banking powers established by Congress under the National Bank Act. The decision also recognized, again citing multiple Supreme Court precedents, that national banks are subject to state laws of

general application to their daily business, if they do not conflict with the provisions or purposes of the National Bank Act.

What the decision does do is provide certainty and a definitive confirmation that the banking business conducted by national banks under powers granted to them by federal law, whether conducted by the bank itself or through the bank's operating subsidiary, is, with limited exception, subject to the OCC's exclusive supervisory authority, and not to state supervisory regimes.

Thus, the *Watters* decision clarifies accountability. Both federal and state agencies have jobs to do. At the OCC, we are committed to ensuring strong protections for national bank consumers under federal standards, and have devoted substantial resources toward that goal. The standards that we apply, and the initiatives that we have taken, belie the notion of a "regulatory gap" in assuring fair treatment of national bank customers. Because of these standards, and the OCC's comprehensive supervisory approach, neither national banks nor their subsidiaries have been, or will become, a "haven" for abusive or predatory practices.

The subprime mortgage situation illustrates this point well. The abuses in the subprime lending business – loan flipping, equity stripping, and making subprime loans that borrowers have no realistic prospect of repaying – simply have not seeped into the national banking system. Hard data show that the quality of the subprime loans that are made by national banks is markedly better than those of other lenders – the delinquency rate has run about half the national average. This is not an accident – it is a reflection of the quality of our supervision and our supervisory standards. Further, hard data also show that most subprime lending is done by non-bank entities regulated exclusively by state authorities. These lenders clearly are – and always have been – subject to the oversight and enforcement jurisdiction of state officials. The *Watters*

decision does nothing to handcuff their ability to prevent these lenders from engaging in abusive practices or making loans that borrowers have no reasonable prospect of repaying.

This leads to a second important point about *Watters*. Critics of the decision contend that state officials should be able to enforce their state laws against national banks, arguing that there can never be "too many cops on the beat." Respectfully, this assertion is simply not true in a world that has only a limited number of "cops." It is counterproductive for state officials to focus their finite supervisory and enforcement resources on national banks and their subsidiaries when those institutions are already extensively supervised by the OCC, and when there are other entities – many of which answer only to state authorities – that are demonstrably the source of problems. Returning to the metaphor, you can indeed have too many cops on the same beat if it means leaving other, more dangerous parts of the neighborhood unprotected.

There is, of course, the possibility that federal standards of consumer protection will differ from state standards. But that does not represent a "gap" in consumer protection for customers of national banks. Rather, the difference reflects the essence of our dual banking system and federalism, where individual states can take different approaches to a particular issue affecting state banks, and any one state's approach may be different from the uniform federal approach for national banks. Again, this is not an unintended regulatory gap, but the inherent and essential result of the different approaches possible – and encouraged – in our dual system of national and state banks. And when Congress wants to ensure the same treatment on any particular issue for all or certain types of lenders or depository institutions, it can do so, and has done so. For example, national banks, state-chartered banks, and thrifts are equally able, under federal law, to charge interest rates permissible under their home state usury laws, even in credit transactions with consumers located in other states.[21]

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[21] *See* 12 U.S.C. §§ 85, 1463(g)(1), and 1831d(a).

In short, the OCC keenly recognizes its consumer protection responsibility, and we expect to be held accountable for how well we do that job. The same should hold true for states. We believe that consumers benefit most when the OCC and the states focus on our respective areas of responsibility, rather than duplicating each other's efforts, and where we find ways to collaborate and share information where that makes the most sense.

B. OCC/State Cooperation

Despite past differences, the OCC and state banking regulators are moving on the right track, we believe, toward the type of cooperation and collaboration that optimizes use of our respective resources and maximizes consumer protection benefits for bank customers. For example, as previously mentioned, we have made significant progress working with our state counterparts to improve consumer complaint information sharing. The model Memorandum of Understanding agreed to by the OCC and the CSBS provides that we and state regulators will refer misdirected complaints to the appropriate agency. It also establishes a mechanism for state agencies to obtain – without compromising consumer privacy – periodic reports from the OCC on the disposition of complaints they have referred to the OCC's Customer Assistance Group. With the assistance of the CSBS, we are in the process of entering into complaint information sharing agreements with individual states, and the process is moving along very well – we have executed 18 such agreements since November, and others are on the horizon. Likewise, the Complaint Referral Express, also previously referred to, is a new technology platform in development that we hope will provide, in 2008, a more automated application to facilitate the transfer of misdirected complaints and referrals between the OCC and other federal and state banking agencies.

In the area of supervisory guidance, the OCC and state regulators have worked constructively in connection with implementation of the nontraditional mortgage guidance issued

by the federal banking agencies, and are following a similar process on the subprime mortgage guidance that the federal banking agencies expect to finalize soon. As the Committee is aware, the guidance issued by the federal banking agencies extends only to the institutions that are supervised by federal regulators. Yet, as noted above, most subprime lending is done by non-bank lenders regulated exclusively by the states. So, it is critical that all states adopt and apply standards comparable to those adopted and applied by the federal banking agencies.

We are encouraged that 35 states have adopted or endorsed similar nontraditional mortgage policies and regulations applicable to those they regulate, and we believe a similar effort will be made with respect to the federal banking agencies' subprime mortgage guidance once it is finalized. We applaud these efforts, led by the CSBS. It bears repeating, however, that neither type of guidance can be fully effective until it is adopted and actually applied by all states, not as a suggestion, but as an expectation. (In this context, we note that several large states are among the 15 that have yet to adopt the nontraditional mortgage guidance, most notably California and Florida.) Uneven implementation and application creates an unlevel playing field where market participants can avoid the new and higher standards by concentrating their activities in those states that have either not adopted or not actually applied such standards – a result we all hope to avoid.

Finally, I am very pleased to announce today an important new cooperative initiative between the OCC and state bank supervisors involving instances in which national banks regulated exclusively by the OCC use independent mortgage brokers regulated exclusively by the states. This intersection of regulatory jurisdiction strikes us, as it did Commissioner Antonakes in a recent Congressional hearing, as fertile ground to coordinate our examination efforts with respect to the nontraditional mortgage guidance already issued and the subprime mortgage guidance about to be issued – especially since there has been much criticism of the role

played by mortgage brokers in these markets. Through parallel examinations of a sample of national banks by the OCC, and examinations of a sample of state-licensed mortgage brokers by the state, we hope to develop a baseline of useful compliance information resulting from this unique congruence of state and federal jurisdictional interests.

IV. SUGGESTIONS FOR IMPROVEMENTS TO CONSUMER PROTECTION REGULATION OF BANKING ACTIVITIES

Finally, the Committee's letter of invitation requested suggestions for improvements to specific aspects of consumer protection regulation applicable to banking activities. In general, we believe the current tools provided to the OCC – in particular, strong supervisory and enforcement authority – are sufficient to address the specific areas of consumer protection regulation that Congress has delegated to the agency. In addition, we are not suggesting the need for additional areas of substantive consumer protection regulation, such as product, rate, or fee regulation, which have traditionally been left to the marketplace – though of course, if Congress chooses to take such a path, the OCC will work closely with this body to implement such change.

Nevertheless, as discussed in more detail below, the OCC does believe that there are several targeted areas in which changes to the status quo would be helpful.

A. Joint Rulemaking Authority to Define Unfair and Deceptive Practices

As previously noted, Congress has not given the OCC a rulemaking role with respect to most of the important federal consumer protection legislation affecting the rights of national bank customers. Vesting such authority in a single regulator such as the Federal Reserve can make sense as a way to establish a single standard applicable to all market participants. But one such area of federal law constitutes a particular anomaly. The FTC Act vests exclusive authority with the Federal Reserve Board, with respect to banks, to promulgate regulations that define unfair or deceptive acts or practices and prescribe restrictions for the purpose of preventing such

acts or practices. Comparable authority is vested in the Office of Thrift Supervision for thrifts, and in the National Credit Union Administration for credit unions. Thus, Congress has already allocated to multiple agencies the task of writing unfair or deceptive practice rules for financial institutions. Yet, left out of this allocation are the FDIC, which supervises over 60 percent of the banks in the United States, and the OCC, which supervises banks holding nearly 70 percent of the country's banking assets.

Accordingly, the OCC would support the extension of FTC Act rulemaking authority to all of the federal banking agencies, so that we could, as necessary, write joint rules that define unfair or deceptive practices and establish requirements that are designed to prevent such acts or practices. Such authority would be helpful to establish across-the-board rules to prohibit especially egregious practices.

I want to emphasize, however, that what we would support is joint rulemaking authority for the federal banking agencies. Because of the potential commonality of the issues across different financial institutions, joint rulemaking would limit the ability of market participants to "forum shop" an aggressive practice to a less stringent regulatory standard adopted by a single regulator. In addition, the vesting of rulemaking authority in one agency, with respect to standards of conduct for entities subject to the jurisdictions of many, may not always produce a result that reflects the views and concerns of other relevant agencies. By giving each regulator a "seat at the table," a joint interagency process would allow a single regulator to prompt discussion of the need for an across-the-board rule – with more weight and credibility than either the OCC or the FDIC has today without any regulatory authority at all.

Of course, coordinated interagency action carries the potential for real frustrations – principally, the delays in implementation that are usually generated by legitimate difficulties in achieving consensus – and we recognize that if that sometimes slow process is not allowed to run

its course, the final results may not be desirable. But coordinated action also may bring countervailing benefits: different perspectives, supervisory experiences, and policy priorities, and the ensuing marketplace of ideas may produce solutions preferable to those resulting from any one agency acting on its own.

Indeed, collaborative interagency action has proven effective in the past, such as in the banking agencies' recent work on nontraditional mortgage guidance and the proposed statement on subprime mortgage products, and in situations where Congress has directed it. For example, in the privacy provisions of the Gramm-Leach-Bliley Act, Congress recognized that the sharing of customer information was a practice of national scope and concern cutting across different types of financial institutions, and that those entities are subject to the jurisdictions of different federal and state regulators. Congress then designed federal standards uniformly applicable to all types of financial services providers, and prescribed that those standards were to be consistently administered by the relevant functional regulators.

While the OCC supports this proposed change in rulemaking authority, let me emphasize that it would by no means be a panacea. Practices that rise to the level of "unfairness" or "deception" under the standards of the FTC Act generally combine both an inordinate degree of risk or harm to the consumer and deficiencies in the information provided that disable the consumer from appreciating the risk or harm in question. They present relatively extreme situations. As a result, recent banking practices that some have criticized as "unfair" in layman's terms – such as ATM fees or the high level of "penalty" credit card interest rates – are not likely to be treated as unfair or deceptive under existing FTC Act precedents if adequately disclosed. It would be difficult for the agencies to prohibit such a practice using the proposed joint rulemaking authority – a more specific directive from Congress would be required.

B. Rulewriting: Required Consultation with Implementing Regulators

As previously discussed, there is logic in vesting a single regulator with rulemaking authority governing all market participants, as is the case with the Federal Reserve for the Truth in Lending Act. Nevertheless, we believe that the regulators who are responsible for implementing and enforcing such rules should be consulted as an integral part of the rulemaking process. Accordingly, we would support statutory changes that require such consultation.

C. More Frequent Revisions to Consumer Protection Regulations

The OCC believes that it would be beneficial to have more frequent reviews and updating of existing consumer protection regulations to help ensure that they better keep pace with developments in consumer financial products and industry practices. Statutory timetables of some sort would help achieve this objective.

D. Centralized Consumer Complaint Function

Finally, the Committee's letter of invitation raised questions about the need for a centralized consumer complaint function that would be available to consumers of any banking organization. As mentioned above, the website that the OCC is about to launch, www.helpwithmybank.gov, is a good step in this direction. But it is not enough. Accordingly, the OCC supports the development of a true "one stop" approach for consumer assistance with banks and their affiliates, including mechanisms for consumers who do not have access to, or do not want to use, the Internet. The federal and state banking regulators should jointly develop such a proposal through the auspices of the FFIEC.

CONCLUSION

At the OCC, we recognize our responsibility with regard to consumer protection. We take that responsibility seriously, and will continue to do so. We are committed to using, and adapting and improving as needed, each of the key elements of our supervisory approach to the

retail banking operations of national banks. And, we are committed to continuing to seek ways to act collaboratively with other federal regulators and our state colleagues to enhance protections available to, and fair treatment of, bank customers.

I appreciate the opportunity to present the OCC's views on the important issues that are the subject of this hearing, and will be pleased to answer any questions that you might have.

* * * *

Attachment A

List of OCC Supervisory Guidance Documents on Consumer Protection Issues

- Advisory Letter 2000-7, "Abusive Lending Practices" (July 25, 2000)
- Advisory Letter 2000-10, "Payday Lending" (Nov. 27, 2000)
- Advisory Letter 2000-11, "Title Loan Programs" (Nov. 27, 2000)
- Advisory Letter 2001-9, "Electronic Fund Transfer Act --Investigations of Unauthorized Transactions" (Sept. 7, 2001)
- Advisory Letter 2002-3, "Guidance on Unfair or Deceptive Acts or Practices" (Mar. 22, 2002)
- Advisory Letter 2003-2, "Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices" (Feb. 21, 2003)
- Advisory Letter 2003-3, "Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans" (Feb. 21, 2003)
- Advisory Letter 2004-4, "Secured Credit Cards" (Apr. 28, 2004)
- Advisory Letter 2004-6, "Payroll Card Systems" (May 6, 2004)
- Advisory Letter 2004-10, "Credit Card Practices"(Sept. 14, 2004)
- Joint Guidance on Overdraft Protection Programs (Feb. 18, 2005)
- OCC Bulletin 2006-34, "Gift Card Disclosures" (Aug. 14, 2006)
- Interagency Guidance on Nontraditional Mortgage Product Risks (Sept. 29, 2006)

Attachment B

List of OCC Enforcement Actions under the FTC Act

- Providian National Bank, Tilton, New Hampshire (consent order – June 28, 2000). We required the bank to set aside not less than $300 million for restitution to affected consumers and to change its credit card marketing program, policies, and procedures.

- Direct Merchants Credit Card Bank, N.A., Scottsdale, Arizona (consent order – May 3, 2001). We required the bank to provide restitution of approximately $3.2 million and to change its credit card marketing practices.

- First National Bank of Marin, Las Vegas, Nevada (consent order – December 3, 2001). We required the bank to set aside at least $4 million for restitution to affected consumers and to change its marketing practices.

- First National Bank, Ft. Pierre, South Dakota (formal agreement – July 18, 2002). We required the bank to change its marketing practices.

- First National Bank in Brookings, Brookings, South Dakota (consent order – January 17, 2003). We required the bank to set aside at least $6 million for restitution to affected consumers, to obtain prior OCC approval for marketing subprime credit cards to non-customers, to cease engaging in misleading and deceptive advertising, and to take other actions.

- Household Bank (SB), National Association, Las Vegas, Nevada (formal agreement – March 25, 2003). We required the bank to provide restitution in connection with private label credit card lending and to make appropriate improvements in its compliance program.

- First Consumers National Bank, Beaverton, Oregon (formal agreement – July 31, 2003). We required the bank to provide refunds of approximately $1.9 million to affected consumers in connection with credit card practices.

- Clear Lake National Bank, San Antonio, Texas (consent order – November 7, 2003). We required the bank to set aside at least $100,000 to provide restitution for borrowers who received tax lien mortgage loans, review a portfolio of mortgage loans to determine if similar violations existed, and take steps to prevent future violations.

- First National Bank of Marin, Las Vegas, Nevada (consent order – May 24, 2004). In a second case involving this bank, we required the bank to set aside at least $10 million for restitution to affected consumers and prohibited the bank from offering secured credit cards in which the security deposit is charged to the consumer's credit card account.

- The Laredo National Bank, Laredo, Texas, and its subsidiary, Homeowners Loan Corporation (formal agreement – November 1, 2005). We required the bank to set aside at least $14 million for restitution to affected customers and to strengthen internal controls to improve compliance with applicable consumer laws and regulations.

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Statement of

Randall S. Kroszner

Member

Board of Governors of the Federal Reserve System

before the

Committee on Financial Services

U.S. House of Representatives

June 13, 2007

Chairman Frank, Ranking Member Bachus, and members of the Committee, I appreciate the opportunity to appear today to discuss the Federal Reserve Board's role in protecting consumers in financial services transactions.

Introduction

An important part of the Federal Reserve's statutory mandate is promoting the availability of credit throughout the banking system. In the case of consumer credit, equally important with promoting its availability is the Federal Reserve's responsibility for implementing the laws designed to protect consumers in financial services transactions. Many of these laws are based on ensuring that consumers receive adequate information in the form of disclosures about the features and risks of a particular product.

Information is critical to the effective functioning of markets. A core principle of economics is that markets are more competitive, and therefore more efficient, when accurate information is available to both consumers and suppliers. When information on alternatives is readily available, product offerings have to meet customers' demands and offering prices have to reflect those of market competitors. If consumers are well informed, they are in a better position to make decisions that are in their best interest. Information helps and empowers individual consumers by improving their ability to compare products and to choose those that will help them meet their personal goals.

With the aid of technological advances, financial institutions have been able to offer innovative products that are increasingly diverse but also increasingly complex. While this has expanded consumers' access to credit and their options, it also presents a challenge in ensuring that consumer disclosures about these more complex products are effective. To be effective, disclosures must give consumers information at a time when it is relevant, and in language they

can easily understand. The information must also be in a format that allows consumers to identify and use the information that is most important to them. In a nutshell, because effective disclosure gives consumers information they notice, understand, and can use, it empowers consumers and enhances competition.

The Board is committed to developing more effective disclosures, but even well-designed disclosures can only be useful if they can be understood by consumers who have the necessary financial knowledge. Accordingly, we must promote financial education, and having been an educator for many years, I am very pleased that the Board is actively involved in this area.

The Board is keenly aware, however, that disclosures and financial education may not always be sufficient to combat abusive practices. Indeed, the consumer financial services laws implemented by the Board contain a number of substantive protections, reflecting carefully considered legislative judgments that certain practices should be restricted or prohibited. The Board also has the responsibility to prohibit other practices by issuing rules, for example, if the Board finds they meet the legal standard for "unfair or deceptive" practices under the Federal Trade Commission Act (FTC Act) or the Home Ownership and Equity Protection Act (HOEPA). We must be mindful, however, of unintended consequences.

Crafting effective rules under the "unfair or deceptive" standard presents significant challenges. Whether a practice is unfair or deceptive depends heavily on the particular facts and circumstances. To be effective, rules must have broad enough coverage to encompass a wide variety of circumstances so they are not easily circumvented. At the same time, rules with broad prohibitions could limit consumers' financing options in legitimate cases that do not meet the required legal standard.

This has led the Federal Reserve to focus primarily on addressing potentially unfair or deceptive practices by using its supervisory powers on a case-by-case basis rather than through rulemaking. The FTC, which has authority to prohibit unfair or deceptive practices for financial services firms that are not depository institutions, has taken a similar approach. Because the prohibition on unfair or deceptive acts or practices applies to all depository institutions as a matter of law, the banking and thrift agencies can and do enforce this prohibition using their supervisory enforcement powers.

The Board also addresses concerns about some practices under other statutes, such as the Truth in Lending Act (TILA) or Truth in Savings Act (TISA). For example, the Board used its HOEPA authority to address the "flipping" of high-cost mortgage loans. Under TILA, we recently proposed a rule prohibiting credit card issuers' from describing their rates as "fixed" unless they specify a period where the rate is not subject to change for any reason. The Board also revised its TISA rules to address concerns about overdraft protection programs. The Board is committed to addressing abusive practices and will consider how it might use its authority to prohibit specific practices consistent with the legal standards in appropriate cases, such as when there are widespread abuses that cannot be effectively addressed through case-by-case determinations in the supervisory process.

The Board's Role in Protecting Consumers

In carrying out its mandate related to consumer protection in financial services, the Federal Reserve has several roles that are carried out through four complementary processes. First, there is the Board's role as rulewriter, in which we issue regulations, either alone or jointly with other federal agencies, to implement the consumer financial services and fair lending laws. Second, there is the Federal Reserve's role in examining the financial institutions that we

supervise for safety and soundness, as well as for compliance with consumer protection laws and regulations. This includes taking supervisory action for the institutions under our jurisdiction, as appropriate, to enforce the laws and resolve any consumer complaints. Third, the Federal Reserve actively promotes consumer education through its publications and through a variety of partnerships with other organizations. Finally, the Federal Reserve's Community Affairs Program supports the Board's objective of promoting community development and fair and impartial access to credit by conducting outreach activities in lower-income communities and traditionally underserved markets. Today, I would like to discuss each of these four roles and some significant actions that the Board has taken in these areas. I will also highlight how the Board is coordinating its efforts with the other federal and state supervisory agencies.

The Board's Rulewriting Responsibilities

The Board has sole responsibility for issuing rules to implement a number of consumer financial services and fair lending laws, including TILA, TISA, the Electronic Fund Transfer Act (EFTA), Consumer Leasing Act, Equal Credit Opportunity Act (ECOA), and Home Mortgage Disclosure Act (HMDA). In conducting these rulemakings, the Board reviews public comment letters and solicits the views of other federal and state regulators who have valuable insights based on their own experience and expertise in supervising financial institutions and protecting consumers. We often obtain the views of other agencies on Board rulemakings through informal outreach efforts, but sometimes we receive written comment letters, as was the case with the Office of the Comptroller of the Currency's (OCC) recent recommendations for revised credit card disclosures. We receive the views of state agencies through such organizations as the Conference of State Bank Supervisors (CSBS), the American Association of Residential

Mortgage Regulators (AARMR), and the National Association of Attorneys General (NAAG), as well as from individual state regulatory agencies.

In addition to the statutes for which the Board has exclusive rulewriting responsibility, the Board shares rulewriting responsibility with other agencies under certain laws, such as the Community Reinvestment Act (CRA) and the Fair Credit Reporting Act (FCRA). Moreover, the Board and other federal financial regulators sometimes play a consulting role in the development of consumer regulations issued by other agencies such as the Department of Housing and Urban Development, and the FTC. For example, most recently, the Board has consulted with the Department of Defense (DOD), as Congress directed with respect to DOD's development of regulations governing loans to members of the armed services and their families.

In addition to its rulemakings to implement statutory changes, the Board updates its regulations in response to the changing marketplace and emerging issues. As markets change and products evolve, questions arise about how existing rules apply in new circumstances. We often address these matters with amendments that specifically target a particular issue, or by updating the interpretations published in the commentaries to our regulations. That was the case with the Board's recent revisions to the rules governing electronic fund transfers, which addressed electronic check conversions and payroll card accounts. It was also the case with our recent amendments to the TISA rules addressing overdraft protection programs.

As a matter of policy, the Board periodically conducts a comprehensive review of each regulation. For the consumer financial services laws, one goal of our regulatory reviews is to develop more effective consumer disclosures. Writing regulations always involves the challenge of crafting rules that are, on the one hand, clear and specific enough to facilitate compliance and promote consistency among financial institutions but, on the other hand, flexible enough to

accommodate market developments as products and pricing continue to change. We also consider ways to eliminate unnecessary burdens consistent with consumer protection. By balancing these interests we seek to avoid imposing undue regulatory burdens that could hinder innovation and raise costs without producing offsetting benefits in consumer protection.

Over the last several years, the Board has completed several regulatory reviews. The Board reviewed the regulations implementing HOEPA and issued revised rules in 2001. The Board's review of the rules implementing HMDA was completed in 2002, resulting in expanded data collection and reporting requirements, and the Board completed a review of the rules implementing ECOA in 2003. Most recently, the Board initiated a review of the TILA rules, which are implemented in the Board's Regulation Z. The initial phase of the Board's review of Regulation Z focused on credit cards and other revolving credit accounts. Last month, the Board issued a proposal for public comment that would substantially revise the rules governing credit cards and improve credit card disclosures. Our review of the Regulation Z rules for mortgage transactions is now under way as well.

The Board's Efforts to Improve the Effectiveness of Credit Disclosures

The Board has recently undertaken an innovative approach to improve the effectiveness of credit disclosures--namely, using consumer surveys and testing to assess consumers' needs and develop our regulatory proposal. Having taught at the University of Chicago's business school for many years, I am well aware of the types of consumer testing that firms have long employed: surveys, focus groups, and so-called "mall intercepts" in which shoppers are interviewed at random. However, it is relatively novel to systematically use such techniques to develop regulatory proposals to improve the effectiveness of disclosures requirements.

Consumer testing can help the Federal Reserve address the considerable challenge of making disclosures more effective by providing insight into consumers' understanding of financial products and their decision-making process. Given the complexity of certain products, such as credit card products with multiple features and nontraditional mortgages, we have to be mindful of the pitfalls of information overload. We must seek to carry out the responsibilities Congress has given us to design disclosures that are not only accurate, but also clear and simple enough that they are meaningful and useful to consumers. Pages of fine print that provide comprehensive descriptions might satisfy lawyers, but the legalese needs to be translated into something consumers can use.

This requires the Board to make judgments about which credit terms are most important to highlight and which could be eliminated. We plan to make these judgments with the benefit of surveys of actual consumers and extensive consumer testing. We recently completed several rounds of consumer testing for credit card disclosures, and that testing was critical to our effort to redesign and, I believe, dramatically improve those disclosures in the proposed regulations recently published for comment.

The substantial investment we have made in developing and testing revised credit card disclosures has given us insights that will contribute to our ability to make mortgage disclosures more effective. We are finding that it is tremendously beneficial to listen to consumers so that we can learn more about how they use information and how we can simplify disclosures and enhance consumers' understanding. Through our testing, we learned firsthand what information consumers find useful when making credit decisions and what information they ignore. Second, we learned what information consumers comprehend and what information they do not. Third,

we saw the impact that different formats and presentation can have on consumers' ability to notice and use the information.

The Board's proposal for credit card accounts would revise the format and content of various credit card disclosures to make them more meaningful and easier to read, and to highlight the various costs. The disclosure table accompanying credit card applications and solicitations would highlight fees and the reasons penalty rates might be applied, such as for paying late. Creditors would be required to use the same type of disclosure table to summarize key terms at account opening and when the account terms change. In addition, format changes to periodic statements--such as grouping fees, interest charges, and transactions together--would make them more understandable. As I noted earlier, card issuers would be prohibited from describing their rates as "fixed" unless they specify a time period where the rate cannot be changed for any reason, or if the rate is fixed for the life of the program.

The proposal to revise the credit card rules would also expand the circumstances under which consumers receive advance notice of changes in their account terms, including advance notice before a penalty rate is applied. Creditors would be required to send notice of a rate increase or other change in terms forty-five days before the change becomes effective, instead of the current fifteen days. The proposal would also revise the rules governing the advertising of open-end credit to help consumers better understand the credit terms being offered.

As I mentioned earlier, the Board plans to conduct extensive consumer testing as part of its review of mortgage disclosures. Like credit cards, mortgage products have become more diverse and more complex. In some cases, creditors are using pricing strategies similar to those used for credit cards, for example, offering customers discounted introductory rates that will be replaced in a short time by a much higher rate, often a variable rate. Of course, there is an

inherent difficulty in adjustable rate mortgage (ARM) disclosures because future interest rate changes are not known. Consumer testing is needed to determine whether, for example, consumers would find disclosure of the "worst-case" payment useful given that such a payment might never occur or might not occur for several years or more, by which time the consumer's own financial circumstances may have changed.

The wider marketing of payment-option mortgages presents another challenge. Consumers have the choice of making low minimum monthly payments that increase the overall cost of the credit and ultimately lead to higher payments. Just as with credit cards, however, disclosing a consumer's repayment obligation and the cost of the credit is more complex when there are unknowns--such as the future rate if it may vary based on an index, the amount of the consumer's monthly payment, and the possibility of negative amortization. When the Board reviews mortgage disclosures, it will consider these developments and conduct extensive consumer testing to determine how the features and risks of today's mortgage products can be communicated effectively.

The Board has already taken some initial steps in its review of mortgage disclosures. Last summer, the Board held a series of four public hearings on home-equity lending, where we gathered views on the impact of federal and state predatory lending laws and on the adequacy of mortgage disclosures, particularly those concerning nontraditional mortgage products. Following those hearings, the Board revised the consumer handbook that creditors are required to provide with applications for all ARMs. The revised handbook gives consumers a better explanation of the features and risks of nontraditional ARMs, especially "payment shock" and the risk of increasing loan balances, also known as "negative amortization."

The recent problems in the subprime mortgage market have prompted the Board to hold a fifth hearing, which I will chair tomorrow, here in Washington, D.C. The purpose of the hearing is to gather information to evaluate how the Federal Reserve might use its rulemaking authority to curb abusive lending practices in the subprime mortgage market in a way that also preserves incentives for responsible lenders. Specifically, hearing participants will discuss concerns about prepayment penalties, escrows for taxes and insurance, "stated-income" loans, and lenders' standards for determining that consumers can afford to make the scheduled payments. Some of these concerns may call for more effective disclosures. However, we will also seriously consider whether there are mortgage lending practices that should be prohibited under HOEPA.

We must be careful, however, not to curtail responsible subprime lending or beneficial financing options for consumers. A robust and responsible subprime mortgage market benefits consumers by allowing borrowers with non-prime or limited credit histories to become homeowners, access the equity in their homes, or have the flexibility to refinance their loans as needed. Under HOEPA, lenders are subject not only to regulatory enforcement actions but also to private lawsuits to redress violations. Thus, any rules should be drawn sharply with bright lines to avoid creating legal and regulatory uncertainty, which could have the unintended effect of substantially reducing consumers access to legitimate credit options.

Supervisory Activities

Examination and Enforcement

The Board has responsibility for enforcing compliance by state-member banks and certain foreign banking organizations with consumer financial services laws, the fair lending laws, and the CRA. Because of the complexity of consumer regulatory requirements, the Board has had a specialized consumer examination program since the late 1970s. The Federal Reserve System has a trained cadre of examiners dedicated solely to this function.

The scope of the consumer compliance examination program has evolved and grown significantly over the years. In 1977, the program covered just nine federal consumer protection laws and regulations. Today the program covers compliance with more than twenty federal laws related to deposits, credit, and the privacy of consumers' financial information. Consumer compliance examinations assess the bank's compliance with ECOA, HMDA, TILA, TISA, RESPA, the EFTA, FCRA, and CRA, section 5 of the FTC Act, and other federal consumer protection laws.

Examinations and other supervisory activities conducted as part of the Board's consumer compliance program follow a risk-focused approach and are tailored to fit the risk profile of the bank. This approach ensures that supervisory resources are directed to the products, services, and areas of the bank's operations that pose the greatest risk to consumers. In addition to assessing an institution's compliance with particular laws and its performance under the CRA, examinations evaluate a bank's processes for identifying, measuring, monitoring, and controlling its risk exposure.

Examiners routinely analyze consumer complaints submitted to the Federal Reserve regarding the bank being examined, looking for any trends, issues, or areas of possible risk. The examiners also analyze any consumer complaints received directly by the bank. The results of this analysis are factored into examiners' decisions regarding the scope of the compliance examination. We view this analysis of consumer complaint activity as an integral component of the examination scoping process. Moreover, consumer complaints can serve as an early warning signal about emerging or potential compliance problems or new industry practices.

The frequency of examinations is a function of an institution's size and prior supervisory ratings. Institutions with less than satisfactory compliance or CRA ratings, regardless of their

size, are typically examined every twelve months. Institutions with assets greater than $250 million and satisfactory or better ratings are examined every twenty-four months. Small banks (those with assets of less than $250 million) with satisfactory or better ratings are typically examined every forty-eight to sixty months. The Federal Reserve Banks also monitor institutions between examinations looking for indicators that could have implications for their compliance efforts and bear on the need for more frequent supervisory intervention. For example, we analyze consumer complaints and consider any changes in supervisory ratings, financial condition, corporate structure, or the institutions' management.

Where Federal Reserve examiners observe weaknesses or compliance failures by supervised institutions, examiners document them in a report to bank management. The required corrective actions are stated in the examination report. We find that in the overwhelming majority of cases, management voluntarily addresses any violations or weaknesses that we have identified without the need for formal enforcement actions. In those rare instances where the bank is not willing to address the problem, we have a full range of enforcement tools at our disposal and use them to compel appropriate corrective action.

We also recognize that cooperation and coordination among the financial institution supervisory agencies are essential to ensuring consistent and effective supervision. Financial institution regulators share information and coordinate activities, such as the development of uniform examination procedures and policies, through the Federal Financial Institutions Examination Council (FFIEC) and other channels. Recently, the CSBS joined the FFIEC, but we have, for many years, coordinated supervisory efforts through the CSBS State and Federal Working Group.

Enforcing the Prohibition Against Unfair or Deceptive Practices

This Committee has specifically asked the agencies to discuss their ability to pursue unfair or deceptive practices by depository institutions. The prohibition on unfair or deceptive acts or practices in section 5 of the FTC Act applies to all banks, thrifts, and credit unions as a matter of law, and may be enforced by each of the federal banking agencies using their supervisory powers under the Federal Deposit Insurance Act. This authority is independent from, and in addition to, the banking agencies' authority to enforce any specific regulations the Board may promulgate.[1] The Board, the OCC, and the Federal Deposit Insurance Corporation (FDIC) have all issued written guidance confirming this view of the agencies' broad authority to enforce the FTC Act. In fact, the Board, OCC, and FDIC have each exercised their supervisory authority in recent years to address the activities of particular banks that the agencies deemed unfair or deceptive.

The lack of rules under the FTC Act does not appear to be an impediment to the agencies' enforcement efforts because a finding of unfairness or deception depends heavily on the facts and circumstances, and must be determined on a case-by-case basis. Rules seeking to define all the circumstances when a particular practice is unacceptable can be too narrow or too broad and, as a result, they may be ineffective or have unintended consequences. In our view, enforcement of the FTC Act on a case-by-case basis, reinforced by agency guidance that establishes standards and recommended practices, is a more effective way to address these concerns.

The Board will, however, continue to assess whether there are unfair or deceptive practices that are appropriately addressed by adopting rules of general applicability under the FTC Act or other consumer protection laws. We will continue to consult with the OCC and

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[1] Section 18 of the FTC Act authorizes the Federal Reserve Board to issue regulations prohibiting specific practices by banks that it finds to be unfair or deceptive. The Office of Thrift Supervision and the National Credit Union Adminstration have the same authority for thrifts and credit unions respectively.

FDIC on these matters. We encourage our fellow bank regulators to bring to our attention particular practices that they believe are unfair or deceptive that can best be addressed by rules of general applicability rather than through the supervisory process.

Supervisory Guidance

The Federal Reserve and other financial institution regulators also use more informal means to protect consumers and promote safe and sound practices by financial institutions. This includes issuing principles-based guidance, which sometimes includes "best practices" that institutions should adopt in following the recommendations contained in the guidance. Principles-based guidance can often be a more flexible tool than rules for accomplishing regulators' goals. This flexibility allows supervisory agencies to adapt the guidance to different situations.

Principles-based guidance is particularly useful when dealing with practices that may be inappropriate in some circumstances but appropriate in others. An example of this is the guidance concerning unfair and deceptive acts or practices ("UDAPs") issued jointly by the Board and FDIC in 2004. The UDAP guidance outlines the legal standards the Board and FDIC use in carrying out their responsibilities for enforcing the FTC Act's prohibition of unfair or deceptive acts or practices. These standards are consistent with those articulated by the OCC and with long-established standards articulated by the FTC in enforcing the FTC Act for non-bank entities. The UDAP guidance outlines strategies for banks to use to avoid engaging in unfair or deceptive acts or practices, to minimize their own risks and to protect consumers. The guidance also lists "best practices" to address some matters seen as having the greatest potential for unfair or deceptive acts or practices: advertising and solicitations; servicing and collections; and the management and monitoring of employees and third-party service providers.

Through the issuance of principles-based guidance, backed-up with regular examinations, the federal depository institution regulators are able to have a significant impact on institutions' practices. Although the supervisory guidance issued by the banking and thrift agencies only applies to depository institutions and their affiliates, state regulators can and sometimes do adopt the federal regulators' guidance for independent nonbank providers of financial services. This was the case with the interagency guidance on nontraditional mortgage products that was issued in 2006. We expect similar action by state regulators for the interagency guidance on subprime mortgage lending that was proposed in March 2007. The agencies are finishing their review of the comment letters received and will work expeditiously to take final action on the proposed statement, including coordinating with the CSBS.

Consumer Complaints

In 1976, the Federal Reserve established a system-wide program for receiving and handling consumer complaints. Through this program, the Board addresses complaints about the banks under its supervision (state-chartered banks that are members of the Federal Reserve System and certain foreign banking organizations) and refers complaints regarding other financial services firms to the appropriate federal or state agency, including the FTC. The Board has established uniform policies and procedures for investigating and responding to consumer complaints, which are implemented by staff of the twelve Federal Reserve Banks who have been specially trained for that purpose. In each of the last two years, the Board has received about 1,900 complaints concerning state-member banks, which number about 900. The Board maintains a database that enables us to track the complaints filed for each institution and how they are resolved.

The Federal Reserve has consistently and promptly referred the consumer complaints we receive to the appropriate state or federal regulator when they do not involve a bank under our

supervision. We also immediately notify consumers of the agency to which their complaint has been referred. Since January 2002, the Federal Reserve System has received over 25,000 consumer complaints. Of these, about 12,000 involved entities other than banks under our supervision and were referred to other agencies. In virtually all of these cases (about 99 percent), the Federal Reserve referred the complaints to the proper agencies and notified the complainants in an average of two business days. Similarly, virtually all of the consumer complaints we received against state member banks and their subsidiaries were promptly acknowledged.

We understand that consumers may face challenges in sorting out where to go for help with questions about financial transactions and in determining where to send complaints. As indicated, we facilitate the process for consumers by ensuring that the complaints we receive are routed quickly and accurately to the right agency for handling. To further enhance our consumer complaint handling process, we recently launched a new online consumer complaint system that creates a single Internet web site for submitting complaints and inquiries to the Federal Reserve. Complaints submitted through the web site are routed automatically to the appropriate Reserve Bank or other supervisory agency.

One feature of the new online system that we plan to activate in the near future is a customer satisfaction questionnaire that will provide us with feedback about consumers' experiences with the Federal Reserve's processing of their complaints. This questionnaire will be an improved version of the one we used for many years. The Board is also establishing a central location for the administrative handling of complaints, which will establish a single mailing address and toll-free telephone number that the public can use. These enhancements underscore our commitment to ensuring the public has an effective and efficient means for

resolving complaints. Our goal is to make a consumer's submission of a complaint as easy and seamless as possible regardless of the entity involved.

To enhance interagency cooperation and coordination in processing consumer complaints, the federal banking agencies held a conference in April 2006 to share information about complaint trends and issues, and learn about best practices in investigating and analyzing complaints. The agency staffs also discussed ways to improve customer service and the potential ways complaint data might be used to aid in the development of consumer education materials. Another interagency conference is scheduled for later this year. In addition to these conferences, the agencies' staffs meet periodically to share complaint data and to discuss emerging issues identified through the complaint process.

Consumer Education and Research

The Federal Reserve is actively engaged in educating consumers about financial transactions so they can better understand their options when shopping for various products. The education materials we produce are based on surveys, consumer testing, and other research about consumer behavior. For example, the Board has published brochures to assist consumers when they are shopping for credit cards, mortgages or leasing a vehicle. We have also issued brochures to help consumers understand their checking accounts and overdraft protection programs, and to educate consumers about the effects of having their payments processed electronically. These publications are also available on the Board's web site.

Recently the Board has focused on helping consumers understand nontraditional mortgage products and ARMs. For example, the Board recently published a consumer education brochure (*Interest-Only Mortgage Payments and Payment-Option ARMs – Are They for You?*) on interest-only mortgages and payment-option ARMs. This brochure describes the loan terms

and risks inherent in such products and alerts borrowers to possible future payment increases. The Board's revised Consumer Handbook on Adjustable Rate Mortgages, which creditors must provide with every ARM application, also seeks to educate consumers about the features and risks of nontraditional mortgage products.

The Federal Reserve's Community Affairs Program

The Federal Reserve's Community Affairs Program supports the Board's objective of promoting community development and fair and impartial access to credit by focusing on low- and moderate-income consumers. We develop programs and build partnerships with organizations to help bring consumers into the financial and economic mainstream. The Community Affairs function within the Board and the Reserve Banks complements other regulatory and compliance activities with programs that educate and equip low- and moderate-income consumers with the tools they need to make better choices in establishing credit and building assets.

The Reserve Banks' Community Affairs programs are specifically focused on improving understanding about low- and moderate-income consumers' needs for and access to financial services. Toward this end, the Reserve Banks engage in research that explores issues relating to consumers' use of financial services products and services. In addition, the Community Affairs Offices convene a research conference every two years dedicated to generating and presenting research that explores current trends in financial services and the implications for lower-income consumers. For example, the most recent conference held this past March in Washington, D.C., offered research on predatory lending and payday lending.

The Federal Reserve Banks also collaborate with local and regional partners to explore opportunities to create awareness of and solutions to address concerns about financial services

issues as they relate to lower-income consumers and communities. Several Reserve Banks have spearheaded initiatives to respond to concerns about rising mortgage defaults and delinquencies, with the San Francisco Federal Reserve Bank holding forums in six cities to discuss community responses. Others Federal Reserve Banks have worked with nonprofit organizations and local governments to develop strategies to improve lower-income consumers' wealth-building opportunities, such as initiatives promoting savings and accessing tax credits.

All twelve Community Affairs Offices have initiatives to promote and support consumer financial education. The Federal Reserve Banks have partnered with financial institutions, nonprofit organizations, local governments, and community institutions to help improve consumers' access to financial education materials and programs. Currently, the Board and the Philadelphia Reserve Bank are conducting long-term research projects to better understand what makes particular consumer counseling and education programs successful.

Conclusion

The Federal Reserve is committed to being proactive in addressing issues that affect consumers in their financial services transactions. We seek to promote the availability of consumer credit while ensuring that consumers receive the information they need to understand their options. Consumers who do not have accurate information and an understanding of what that information means will have difficulty choosing among competing products. Because information is critical to more competitive, and thus more efficient markets, more effective disclosure also has the capacity to weed out some abuses.

By using consumer testing systematically, the Federal Reserve is taking an innovative approach to revising its regulations and improving the effectiveness of disclosures. At the same time, we will continue our cooperation with educational and community organizations around the country to help inform and support consumer education efforts. We recognize, however, that

disclosures and financial education may not always be sufficient to combat abusive practices. Because some bad lending practices may require additional measures, the Federal Reserve will seriously consider how we might use our rulemaking authority to address abusive practices without restricting consumers' access to beneficial financing options and responsible subprime credit. We will, along with the other supervisory agencies, also continue to actively use our other tools--such as supervisory guidance, the examination process, and our enforcement powers--to address specific practices that are abusive or otherwise inappropriate.

PREPARED STATEMENT OF

THE FEDERAL TRADE COMMISSION

on

CONSUMER PROTECTION IN FINANCIAL SERVICES

Before the

HOUSE COMMITTEE ON FINANCIAL SERVICES

Washington, D.C.

June 13, 2007

I. INTRODUCTION

Chairman Frank, Ranking Member Bachus, and Members of the Committee, I am Deborah Platt Majoras, Chairman of the Federal Trade Commission ("FTC" or "Commission").[1] I appreciate the opportunity to appear before you today to discuss the Commission's efforts to combat unfair, deceptive, and other illegal practices in the consumer financial services industry. Financial issues affect all consumers – whether they are purchasing homes, trying to establish credit and improve their credit ratings, or managing rising debt. The FTC protects consumers at every stage of the consumer credit life cycle, from advertising and marketing of financial products to debt collection and "debt relief." The Commission's activities are focused on assisting consumers in obtaining the information they need to make informed financial decisions, and on protecting them from unlawful acts and practices that are likely to cause them harm.

Among other things, the FTC would like to emphasize the following points:

- The FTC uses three main tools to protect consumers of financial services from harm: law enforcement, consumer education, and policy research and development.

- The Commission's recent law enforcement actions in the financial services marketplace have targeted deception and illegal practices in: (1) mortgage lending and servicing; (2) non-mortgage lending and leasing; (3) gift card sales; (4) advance fee loan scams; (5) debt collection practices; (6) credit and debt counseling services; and (7) credit reporting.

- The FTC has targeted deceptive or unfair practices in all stages of mortgage lending – from advertising and marketing through loan servicing. In the past decade, the Commission has brought 21 such actions, focusing in particular on the subprime market. As a result of these actions, courts collectively have ordered more than $320 million to be returned to consumers. The Commission currently has several ongoing, non-public investigations of companies in the subprime lending industry.

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[1] The views expressed in this statement represent the views of the Commission. My oral presentation and responses to any questions you have are my own, however, and do not necessarily reflect the views of the Commission or any other Commissioner.

• Because law enforcement is most effective when government officials cooperate, we have worked together with other federal and state agencies in some of the financial services cases we have investigated and prosecuted. Currently, representatives of federal and state agencies are discussing how to improve complaint sharing among law enforcers.

• To empower consumers to avoid harm, the Commission has developed extensive consumer education programs addressing financial services, and we recently have expanded the reach of these efforts. In fiscal year 2006, the Commission distributed more than 4.1 million printed copies of financial education brochures, in both English and Spanish; "hits" on the FTC's Web site for the same materials exceeded 6.2 million.

• The Commission engages in broad-based research and policy development concerning financial services to adapt its policies to protect consumers more effectively.

• Last year, following an FTC public workshop concerning nontraditional mortgage products, the Commission filed comments with the Federal Reserve Board emphasizing that consumers must obtain all of the relevant information needed to make an informed choice at each stage of the mortgage process, especially for nontraditional mortgage products.

• Today the FTC's Bureau of Economics released a study that confirms the need to improve mortgage disclosures. The Commission would be pleased to work with the Federal Reserve Board and Department of Housing and Urban Development as they work on improving mortgage disclosures.

• The FTC will continue to develop policy responses on financial services issues; in October, the Commission will hold a public workshop to examine changes in the debt collection industry and their impact on consumers and competition.

This testimony will discuss in more detail (1) the Commission's authority in the consumer financial services industry; (2) the FTC's activities protecting consumers in that marketplace in recent years; and (3) the Commission's cooperation with other regulators.

II. THE COMMISSION'S LEGAL AUTHORITY

The Commission has wide-ranging responsibilities regarding consumer financial issues. The FTC targets many types of practices in the area, from fraud in which, for example, telemarketers collect fees for non-existent loans, to legitimate businesses failing to comply with specific statutory mandates, for example, failing to provide the disclosures required by the

Consumer Leasing Act.[2] The Commission's enforcement actions have involved companies large and small in various regions of the country.

The Commission enforces Section 5 of the Federal Trade Commission Act ("FTC Act"), which broadly prohibits unfair or deceptive acts or practices in commerce.[3] The Commission also enforces statutes that address specific aspects of lending practices, including the Truth in Lending Act ("TILA")[4] and the Home Ownership and Equity Protection Act ("HOEPA").[5] Moreover, the Commission enforces a number of other consumer protection statutes that govern financial services providers, such as the Consumer Leasing Act, the Fair Debt Collection Practices Act ("FDCPA"),[6] the Fair Credit Reporting Act ("FCRA"),[7] the Equal Credit Opportunity Act,[8] the Credit Repair Organizations Act ("CROA"),[9] the Telemarketing and

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[2] 15 U.S.C. §§ 1667-1667f (requiring disclosures, limiting balloon payments, and regulating advertising in connection with consumer lease transactions).

[3] 15 U.S.C. § 45(a).

[4] 15 U.S.C. §§ 1601-1666j (requiring disclosures and establishing other requirements in connection with consumer credit transactions).

[5] 15 U.S.C. § 1639 (providing additional protections for consumers who enter into certain high-cost refinance mortgage loans). HOEPA is a part of the TILA.

[6] 15 U.S.C. §§ 1692-1692o (prohibiting abusive, deceptive, and unfair debt collection practices by third-party debt collectors).

[7] 15 U.S.C. §§ 1681-1681x (imposing standards for consumer reporting agencies and information furnishers in connection with the credit reporting system and placing restrictions on the use of credit reporting information). The Fair and Accurate Credit Transactions Act of 2003 amended the FCRA.

[8] 15 U.S.C. §§ 1691-1691f (prohibiting creditor practices that discriminate on the basis of race, color, religion, national origin, sex, marital status, age [provided the applicant has the capacity to contract], receipt of public assistance, and exercise of certain legal rights).

[9] 15 U.S.C. §§ 1679-1679j (requiring disclosures and prohibiting unfair or deceptive advertising and business practices by credit repair organizations).

Consumer Fraud and Abuse Prevention Act,[10] and the privacy provisions of the Gramm-Leach-Bliley Act ("GLB").[11]

Several federal agencies have authority over entities in the financial services marketplace. The FTC Act and the other statutes that the FTC enforces specifically exempt banks, savings and loan institutions, and federal credit unions from the agency's jurisdiction.[12] But, the Commission does have jurisdiction over nonbank financial companies, including nonbank mortgage companies, mortgage brokers, finance companies, and units of bank holding companies.[13] The FTC engages in aggressive law enforcement as to entities under its jurisdiction and collaborates with other agencies where practicable.

III. THE COMMISSION'S RECENT ACTIVITIES

The Commission uses all of the tools at its disposal – law enforcement, consumer education, and policy research and development – to fulfill its mission of protecting consumers of financial services.

A. Law Enforcement

Many Commission law enforcement actions have targeted deception and other illegal practices in the financial services marketplace. The agency's recent law enforcement activity has focused primarily on seven subjects: (1) mortgage lending and servicing; (2) non-mortgage lending and leasing; (3) gift card sales; (4) advance fee credit scams; (5) debt collection

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[10] 15 U.S.C. §§ 6101-6108 (protecting consumers from telemarketing fraud and abuse).

[11] 15 U.S.C. §§ 6801-6809 (imposing requirements on financial institutions with respect to annual privacy notices, procedures for providing customers an opt-out from having certain information shared with nonaffiliated third parties, and safeguarding customers' personally identifiable information).

[12] *E.g.*, 15 U.S.C. § 5(a)(2).

[13] The Commission generally engages in law enforcement investigations but does not engage in regular examinations of entities within its jurisdiction.

practices; (6) credit and debt counseling services; and (7) credit reporting.[14]

1. Mortgage Lending and Servicing

In the last decade, the agency has brought 21 actions against companies in the mortgage lending industry, focusing in particular on the subprime market.[15] Several of these cases have resulted in large monetary judgments, with courts collectively ordering that more than $320 million be returned to consumers. These enforcement actions have targeted deceptive or unfair practices in all stages of mortgage lending – from advertising and marketing through loan servicing – by mortgage lenders, brokers, and loan servicers.

In most of its mortgage lending cases, the Commission has challenged alleged deception in the advertising or marketing of subprime loans. For example, the FTC's complaint against Associates First Capital Corporation and Associates Corporation of North America ("the Associates") alleged that the defendants marketed subprime mortgage loans through false and misleading statements about loan costs.[16] The Associates represented that consumers would save

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[14] Other high priorities for the Commission in the financial area are financial privacy, data security, and identity theft. For a description of some of these recent cases, *see* FTC, THE FTC IN 2007: A CHAMPION FOR CONSUMERS AND COMPETITION (April 2007), *available at* http://www.ftc.gov/os/2007/04/ChairmansReport2007.pdf (pdf pages 29-30, 37).

[15] *FTC v. Mortgages Para Hispanos.Com Corp.*, No. 06-00019 (E.D. Tex. 2006); *FTC v. Ranney*, No. 04-1065 (D. Colo. 2004); *FTC v. Chase Fin. Funding*, No. 04-549 (C.D. Cal. 2004); *United States v. Fairbanks Capital Corp.*, No. 03-12219 (D. Mass. 2003); *FTC v. Diamond*, No. 02-5078 (N.D. Ill. 2002); *United States v. Mercantile Mortgage Co.*, No. 02-5079 (N.D. Ill. 2002); *FTC v. Associates First Capital Corp.*, No. 01-00606 (N.D. Ga. 2001); *FTC v. First Alliance Mortgage Co.*, No. 00-964 (C.D. Cal. 2002); *United States v. Action Loan Co.*, No. 00-511 (W.D. Ky. 2000); *FTC v. NuWest, Inc.*, No. 00-1197 (W.D. Wash. 2000); *United States v. Delta Funding Corp.*, No. 00-1872 (E.D.N.Y. 2000); *FTC v. Barry Cooper Prop.*, No. 99-07782 (C.D. Cal. 1999); *FTC v. Capitol Mortgage Corp.*, No. 99-580 (D. Utah 1999); *FTC v. CLS Fin. Serv., Inc.*, No. 99-1215 (W.D. Wash. 1999); *FTC v. Granite Mortgage, LLC*, No. 99-289 (E.D. Ky. 1999); *FTC v. Interstate Res. Corp.*, No. 99-5988 (S.D.N.Y. 1999); *FTC v. LAP Fin. Serv., Inc.*, No. 99-496 (W.D. Ky. 1999); *FTC v. Wasatch Credit Corp.*, No. 99-579 (D. Utah 1999); *In re First Plus Fin. Group, Inc.*, FTC Docket No. C-3984 (2000); *In re Fleet Fin., Inc.*, FTC Docket No. C-3899 (1999); *FTC v. Capital City Mortgage Corp.*, No. 98-00237 (D.D.C. 1998).

[16] *FTC v. Associates First Capital Corp.*, No. 01-00606 (N.D. Ga. 2001).

money when consolidating their existing debts, but these "savings claims" did not take into account the loan fees and closing costs the company typically added to the consumers' loan amounts. Further, the claims did not reveal that, for certain Associates loans, consumers would pay only interest and would still owe the entire principal amount in a "balloon" payment at the end of the loan term. The complaint also challenged as deceptive the Associates' practice of including single-premium credit insurance in loans, without disclosing its inclusion to consumers. The defendants paid a record-setting $215 million in consumer redress to settle the FTC complaint.[17]

With mortgage brokers now originating between 65-70% of mortgage loans,[18] the Commission has brought several recent enforcement actions against these entities for allegedly deceiving consumers about key loan terms, such as the existence of a prepayment penalty[19] or a large balloon payment due at the end of the loan.[20] Similarly, the Commission has charged brokers with falsely promising consumers low fixed payments and rates on their mortgage loans.[21] For example, in June 2004, the Commission sued Chase Financial Funding ("CFF"), a California mortgage broker, and its principals, in connection with sending unsolicited email and

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[17] *FTC v. Associates First Capital Corp.*, No. 01-00606 (N.D. Ga. Jan. 26, 2002) (Order Preliminarily Approving Stipulated Final Judgment and Order). Defendants paid an additional $25 million to settle a concurrent class action.

[18] *See* NEW RESEARCH ABOUT MORTGAGE BROKERS PUBLISHED (July 28, 2005), and other data, available at *www.wholesaleaccess.com*.

[19] *FTC v. Chase Fin. Funding*, No. 04-549 (C.D. Cal. 2004); *FTC v. Diamond*, No. 02-5078 (N.D. Ill. 2002).

[20] *FTC v. Diamond*, No. 02-5078 (N.D. Ill. 2002).

[21] *FTC v. Chase Fin. Funding*, No. 04-549 (C.D. Cal. 2004); *FTC v. Ranney*, No. 04-1065 (D. Colo. 2004); *FTC v. Diamond*, No. 02-5078 (N.D. Ill. 2002).

direct mail promising a "3.5% fixed payment loan."[22] The Commission alleged that CFF did not offer any such loan – in fact, if consumers chose to pay the advertised payment amounts, then their principal balances would increase, and after an introductory period, they would be forced to make higher monthly payments. The litigation in this matter is ongoing.

Most recently, in 2006, the Commission filed suit against a mortgage broker for allegedly deceiving Hispanic consumers who sought to refinance their homes by misrepresenting numerous key loan terms.[23] The alleged conduct was egregious because the lender conducted business with his clients almost entirely in Spanish, and then provided at closing loan documents in English containing the less favorable terms. To settle the suit, the broker paid $10,000 in consumer redress and agreed to a permanent injunction prohibiting him from misrepresenting loan terms.[24]

The Commission also has challenged allegedly deceptive and unfair practices in the servicing of mortgage loans.[25] For example, in November 2003, the Commission, along with the Department of Housing and Urban Development ("HUD"), announced a settlement with Fairbanks Capital Corp. and its parent company. Fairbanks (now called Select Portfolio Servicing, Inc.) had been one of the country's largest third-party subprime loan servicers – it did not originate any loans, but collected and processed payments on behalf of the holders of the mortgage notes. The Commission alleged that Fairbanks failed to post consumers' payments

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[22] *FTC v. Chase Fin. Funding*, No. 04-549 (C.D. Cal. 2004).

[23] *FTC v. Mortgages Para Hispanos.Com Corp.*, No. 06-00019 (E.D. Tex. 2006).

[24] *FTC v. Mortgages Para Hispanos.Com Corp.*, No. 06-00019 (E.D. Tex. Sept. 25, 2006) (Stipulated Final Judgment and Order of Permanent Injunction) (entering suspended judgment of $240,000 and ordering payment of $10,000 based on documented inability to pay full judgment amount).

[25] *United States v. Fairbanks Capital Corp.*, No. 03-12219 (D. Mass. 2003); *FTC v. Capital City Mortgage Corp.*, No. 98-00237 (D.D.C. 1998).

upon receipt, charged unauthorized fees, used dishonest or abusive tactics to collect debts, and reported consumer payment information that it knew to be inaccurate to credit bureaus. To resolve these charges, Fairbanks and its former chief executive officer paid over $40 million in consumer redress, agreed to halt the alleged illegal practices, and implemented significant changes to company business practices to prevent future violations.[26] The Commission is continuing to investigate companies in the mortgage lending industry, focusing in particular on the subprime market.[27]

2. Non-Mortgage Lending and Leasing

The FTC frequently has challenged the sales practices used in the personal (unsecured) loan industry. For instance, the Commission charged a regional subprime lending company, Stewart Finance, and its affiliates with making deceptive claims in selling small personal loans.[28] The complaint alleged that defendants engaged in deception to induce consumers to purchase expensive add-on products to obtain costly refinance loans, and to pay fees to participate in a "direct deposit" program. In January 2006, the court entered a stipulated judgment banning defendants from engaging in lending and related activities and imposing a $10.5 million redress amount.[29]

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[26] *United States v. Fairbanks Capital Corp.*, No. 03-12219 (D. Mass. Nov. 21, 2003) (Order Preliminarily Approving Stipulated Final Judgment and Order as to Fairbanks Capital Corp. and Fairbanks Capital Holding Corp.); *United States v. Fairbanks Capital Corp.*, No. 03-12219 (D. Mass. Nov. 21, 2003) (Stipulated Final Judgment and Order as to Thomas D. Basmajian).

[27] Moreover, the Commission has initiated actions against several realtor groups operating Multiple Listing Services charging that they engaged in anticompetitive conduct that hampered consumers' ability to obtain low-cost real estate brokerage services. *E.g.*, FTC Press Release, "FTC Charges Real Estate Groups with Anticompetitive Conduct in Limiting Consumers' Choice in Real Estate Services" (Oct. 12, 2006).

[28] *FTC v. Stewart Finance Company Holdings, Inc.*, No. 03-2648 (N.D. Ga. 2003).

[29] *FTC v. Stewart Finance Company Holdings, Inc.*, No. 03-2648 (N.D. Ga. Jan. 10, 2006) (Stipulated Final Judgment and Order) (note that the FTC does not expect to collect the full amount of its

With respect to automobile leasing, the Commission has worked to halt the practice of omitting or burying key cost information in small and unreadable print in automobile lease advertisements.[30] The Consumer Leasing Act and its implementing Regulation M,[31] which govern lease transactions, require that advertisements for leasing plans that contain specific terms also state clearly and conspicuously certain additional terms of the offer. These terms include, among other things, the fact that the transaction advertised is a lease; the total amount of any payments such as a security deposit required at lease inception; and the number, amount and timing of scheduled payments. The agency's actions have resulted in significant improvements to national advertisements for automobile leases.

3. Gift Cards

The Commission also has brought cases against sellers of gift cards that carried concealed fees or expiration dates. Sales of gift cards have exploded in the marketplace in recent years and generated nearly $28 billion in sales during the 2006 holiday season.[32] Some gift cards, however,

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judgment because the companies filed petitions for bankruptcy relief during the course of the litigation and owe substantial amounts to other creditors).

[30] *See In re R.N. Motors, Inc.*, FTC Docket No. C-3947 (Apr. 27, 2000); *In re Simmons Rockwell Ford Mercury, Inc.*, FTC Docket No. C-3950 (Apr. 27, 2000); *In re Chrysler Corp.*, FTC Docket No. C-3847 (Jan. 4, 1999); *In re Martin Advertising*, FTC Docket No. C-3846 (Jan. 4, 1999); *In re Bommarito Oldsmobile, Inc.*, FTC Docket No. C-3774 (Jan. 5, 1998); *In re Toyota Motor Sales, U.S.A., Inc.*, FTC Docket No. C-3776 (Jan. 5, 1998); *In re Beuckman Ford, Inc.*, FTC Docket No. C-3777 (Jan. 5, 1998); *In re Volkswagen of America, Inc.*, FTC Docket No. C-3778 (Jan. 5, 1998); *In re Suntrup Ford, Inc.*, FTC Docket No. C-3779 (Jan. 5, 1998); *In re Lou Fusz Automotive Network, Inc.*, FTC Docket No. C-3780 (Jan. 5, 1998).

[31] 15 U.S.C. § 1667-1667f; 12 C.F.R. § 213.

[32] Press Release, Nat'l Retail Fed'n, "Gift Card Spending Surpassed Expectations as Last-Minute Shoppers Looked for Quick, Easy Gifts" (Jan. 23, 2007); *see also* MONTGOMERY COUNTY, MARYLAND, DIVISION OF CONSUMER AFFAIRS, GIFT CARDS 2006: RETAIL CARDS CONTINUE TO IMPROVE (WITH PRODDING); BANK CARDS STILL HAVE PROBLEMS (Nov. 28, 2006), *available at* http://www.montgomerycountymd.gov/content/ocp/giftcardreportfinal2006.pdf; MONTGOMERY COUNTY, MARYLAND, DIVISION OF CONSUMER AFFAIRS, GIFT CARDS 2005: MANY GOOD RETAIL CARDS. ANY GOOD BANK CARDS? (Dec. 1, 2005), *available at* http://www.montgomerycountymd.gov/content/ocp/consumer/gift_cards_report_2005.pdf.

charged consumers "dormancy" fees – fees imposed against the cards during periods of non-use – or imposed expiration dates without sufficiently informing purchasers of these important limitations. The FTC recently settled separate cases against two such gift card retailers, Kmart Corporation and Darden Restaurants, Inc., alleging that they failed to disclose adequately to consumers the fees associated with their cards.[33] The settlements prohibit Kmart and Darden from marketing cards with dormancy fees or expiration dates without clearly and prominently disclosing their existence on the front of the gift cards, and disclosing certain material terms to consumers at the point of sale prior to purchase. The Commission further mandated that each company adopt a program to reimburse eligible consumers whose cards were previously charged fees.

4. Advance Fee Credit Scams

The FTC has sued fraudulent marketers in over 60 cases since 1998 alleging that they charged advance fees but did not provide consumers with credit as promised.[34] In some cases, the defendants promised credit cards, and in other cases, the defendants promised unsecured loans. The Commission's Telemarketing Sales Rule ("TSR") explicitly prohibits telemarketers from requesting or receiving payment of any fee in advance of obtaining credit, if the telemarketer has represented a high likelihood of success in obtaining or arranging the extension

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[33] *In re Kmart Corp.*, FTC File No. 0623088 (Mar. 12, 2007) (proposed order); *In re Darden Restaurants, Inc.*, FTC Docket No. C-4189 (Apr. 3, 2007) (final order).

[34] *E.g., FTC v. Remote Response Corp.*, No. 06-20168 (S.D. Fla. 2006); *FTC v. Centurion Fin. Benefits LLC*, No. 05-5542 (N.D. Ill. 2005); *FTC v. 3RBancorp*, No. 04-7177 (N.D. Ill. 2004); *FTC v. SunSpectrum Commc'ns Org., Inc.*, No. 03-8110 (S.D. Fla. 2003); *FTC v. Platinum Universal, LLC*, No. 03-61987 (S.D. Fla. 2003); *FTC v. Assail, Inc.*, No. 03-007 (W.D. Tex. 2003); *FTC v. Star Credit Servs., Inc.*, No. 02-4500 (E.D.N.Y. 2002); *FTC v. Capital Choice Consumer Credit, Inc.*, No. 02-21050 (S.D. Fla. 2002); *FTC v. Bay Area Business Council, Inc.*, No. 02-5762 (N.D. Ill. 2002); *FTC v. 1st Beneficial Credit Servs. LLC*, No. 02-1591 (N.D. Ohio 2002); *FTC v. Membership Servs., Inc.*, No. 01-1868 (S.D. Cal. 2001); *FTC v. American Consumer Membership Servs.*, No. 99-1206 (N.D.N.Y. 1999).

of credit.[35] The FTC moves expeditiously to stop practices that violate the TSR and the FTC Act and to obtain monetary relief for injured consumers.

5. Debt Collection

Protecting consumers from debt collection abuses is another critical part of the Commission's mission. The agency receives more complaints about third-party debt collectors than any other single industry, with nearly 70,000 complaints in 2006. Since 1998, the FTC has brought twenty lawsuits for illegal debt collection practices.[36] In these cases, the Commission has obtained tough permanent injunctive relief, such as banning some defendants from engaging in debt collection. The FTC also has obtained large amounts in monetary relief, including a record $10.2 million judgment ordered in a recent case.[37]

The FTC continues to focus on preventing debt collectors from harming consumers. Just yesterday, the Commission filed a case under seal against defendants who collected purported debts from Spanish speaking consumers. Since 2006, the defendants often posed as third-party

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[35] 16 C.F.R. § 310.4(a)(4).

[36] *FTC v. Rawlins & Rivera, Inc.*,No. 07-146 (M.D. Fla. 2007); *United States v. Whitewing Fin.*, No. 06-2102 (S.D. Tex. 2006); *FTC v. Check Investors, Inc.*, No. 03-2115 (D.N.J. 2005), *appeal docketed*, Nos. 05-3558, 05-3957 (3rd Cir. Aug. 2, 2005); *United States v. Capital Acquisitions and Mgmt. Corp.*, No. 04-50147 (N.D. Ill. 2004); *FTC v. Capital Acquisitions and Mgmt. Corp.*, No. 04-7781 (N.D. Ill. 2004); *In re Applied Card Sys., Inc.*, FTC Docket No. C-4125 (Oct. 8, 2004); *United States v. Fairbanks Capital Corp.*, No. 03-12219 (D. Mass. 2003); *FTC v. Associates First Capital Corp.*, No. 01-00606 (N.D. Ga. 2002); *United States v. DC Credit Servs., Inc.*, No. 02-5115 (C.D. Cal. 2002); *United States v. United Recovery Sys., Inc.*, No. 02-1410 (S.D. Tex. 2002); *United States v. North American Capital Corp.*, No. 00-0600 (W.D.N.Y. 2000); *United States v. National Fin. Sys., Inc.*, No. 99-7874 (E.D.N.Y. 1999); *Perimeter Credit, L.L.C.*, No. 99-0454 (N.D. Ga. 1999); *In re Federated Dep't Stores, Inc.*, FTC Docket No. C-3893 (Aug. 27, 1999); *FTC v. Capital City Mortgage Co.*, No. 98-00237 (D.D.C. 1998); *United States v. Nationwide Credit, Inc.*, No. 98-2920 (N.D. Ga. 1998); *United States v. Lundgren & Assocs., P.C.*, No. 98-1274 (E.D. Cal. 1998); *In re May Dep't Stores Co.*, FTC Docket No. C-3848 (Nov. 2, 1998); *In re General Elec. Capital Corp.*, FTC Docket No. C-3839 (Dec. 23, 1998).

[37] *FTC v. Check Investors, Inc.*, No. 03-2115 (D.N.J. 2005), *appeal docketed*, Nos. 05-3558, 05-3957 (3rd Cir. Aug. 2, 2005).

debt collectors and called consumers who previously purchased or merely inquired about a product and misrepresented that the consumers owed large outstanding amounts relating to that product. The defendants repeatedly called consumers, sometimes posing as attorneys and threatening out-of-state litigation, home foreclosure, and even incarceration. Numerous consumers acquiesced to the defendants' demands. The Commission is seeking injunctive relief, an asset freeze, appointment of a receiver, and consumer redress.

In addition, in February of this year, the Commission charged a collection agency, Rawlins & Rivera, Inc., and its principals with violating federal law by falsely threatening consumers with lawsuits, seizure of property, and arrest, and violating specific FDCPA provisions.[38] The court granted the FTC's request for a preliminary injunction,[39] and the litigation is continuing.

6. Credit and Debt Counseling

The Commission has prosecuted over a dozen companies that allegedly purport to offer debt relief but misrepresent the cost or nature of the relief.[40] In its largest case, the FTC in 2003 sued AmeriDebt, Inc., a purported credit counseling organization. The Commission alleged that AmeriDebt deceived consumers with claims that it was a nonprofit organization that provided

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[38] *FTC v. Rawlins & Rivera, Inc.*, No. 07-146 (M.D. Fla. 2007).

[39] *FTC v. Rawlins & Rivera, Inc.*, No. 07-146 (M.D. Fla. Apr. 6, 2007) (Order Granting Motion for Preliminary Injunction).

[40] *FTC v. Debt-Set*, No. 07-558 (D. Colo. 2007); *FTC v. Select Personnel Mgmt., Inc.*, No. 07-0529 (N.D. Ill. 2007); *FTC v. Dennis Connelly*, No. 06-701 (C.D. Cal. 2006); *FTC v. Express Consolidation*, No. 06-61851 (S.D. Fla. 2006); *US v. Credit Found. of Am.*, No. 06-3654 (C.D. Cal. 2006); *FTC v. Debt Solutions, Inc.*, No. 06-0298 (W.D. Wash. 2006); *FTC v. Debt Mgmt. Found. Servs., Inc.*, No. 04-1674 (M.D. Fla. 2004); *FTC v. Integrated Credit Solutions, Inc.*, No. 06-00806 (M.D. Fla. 2006); *FTC v. National Consumer Council, Inc.*, No. 04-0474 (C.D. Cal. 2004); *FTC v. Better Budget Fin. Servs., Inc.*, No. 04-12326 (D. Mass. 2004); *FTC v. Innovative Sys. Tech., Inc., d/b/a Briggs & Baker*, No. 04-0728 (C.D. Cal. 2004); *FTC v. Jubilee Fin. Servs., Inc.*, No. 02-6468 (C.D. Cal 2002).

bona fide debt counseling services, when in fact it funneled profits to affiliated for-profit entities and individuals.[41] The Commission also alleged that AmeriDebt deceived customers by claiming that it did not charge an up-front fee, when in fact AmeriDebt kept its clients' first payments as a fee, rather than disbursing the money to their creditors as promised. On the eve of trial, AmeriDebt's founder agreed to a $35 million settlement.[42]

Similarly, the Commission has acted aggressively against "credit repair" scams, which have long been marketed as a quick and easy method to cleanse individual credit reports of negative information. The FTC has brought over 50 cases since 1998 against actors that allegedly have misrepresented the credit-related services they provide consumers.[43] For example, in February 2006, the Commission, along with federal and state law enforcement partners, announced a crackdown on 20 credit repair organizations.[44] As part of this effort, the FTC charged Bad Credit B Gone, LLC with violating the FTC Act and the CROA by claiming it could improve most consumers' credit reports by removing negative information that was accurate and

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[41] *FTC v. AmeriDebt, Inc.*, No. 03-3317 (D. Md. 2003).

[42] *See FTC v. AmeriDebt, Inc.*, No. 03-3317 (D. Md. Jan. 9, 2006) (Stipulated Final Judgment and Permanent Injunction as to DebtWorks, Inc. and Andris Pukke). Subsequently, the court-appointed receiver determined that primary defendant Andris Pukke had hidden assets from the FTC, and the court entered a judgment requiring him to turn over tens of millions of dollars' worth of additional assets. Because he resisted turning over his assets even after the court found him in contempt of court, the Court ordered his incarceration pending full cooperation, lasting almost a month.

[43] *E.g., FTC v. Sunshine Credit Repair, Inc.*, No. 05-20228 (S.D. Fla. 2005); *FTC v. Service Brokers Assoc., Inc.*, No. 05-60129 (S.D. Fla. 2005); *FTC v. ICR Services, Inc.*, No. 03-5532 (N.D. Ill. 2003); *FTC v. Cliff Cross, individually and d/b/a Build-It-Fast*, No. 99-018 (W.D. Tex. 2001); *FTC v. Patrick R. P.R.K. Enters.*, No. 99-562 (E.D.N.Y. 1999); *United States v. Cornerstone Wealth Corp.*, No. 98-0601 (N.D. Tex. 1998); *United States v. Jack Schrold*, No. 98-6212 (S.D. Fla. 1998); *FTC v. Midwest Mgmt. Assocs., Inc.*, No. 98-1218 (N.D. Ill. 1998).

[44] FTC Press Release, *"Project Credit Despair" Snares 20 "Credit Repair" Scammers* (Feb. 2, 2006), *available at* http://www.ftc.gov/opa/2006/02/badcreditbgone.shtm.

not obsolete.[45] The court ruled that defendants had violated the law and ordered them to pay more than $322,000 in equitable monetary relief.[46]

7. Credit Reporting

The Commission has pursued an aggressive enforcement program to ensure compliance with the FCRA. The Commission has taken action against violations involving all three of the principal players in the credit reporting system – consumer reporting agencies (CRAs), furnishers of information to the CRAs, and consumer report users. For example, the Commission has brought cases in the past few years against the three major nationwide CRAs, obtaining nearly $3 million in civil penalties.[47]

The Commission's action last year against ChoicePoint, Inc. is one of the most notable examples of the Commission's enforcement.[48] The FTC lawsuit alleged that ChoicePoint, Inc. violated the Fair Credit Reporting Act and the FTC Act by failing to screen prospective subscribers before selling them sensitive consumer information. Under the terms of a settlement,

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[45] *FTC v. Bad Credit B Gone, LLC*, No. 06-0254 (N.D. Ill. 2006).

[46] *FTC v. Bad Credit B Gone, LLC*, No. 06-0254 (N.D. Ill. Apr. 21, 2006) (Minute Entry Before Judge James F. Holderman: Plaintiff's Motion for Entry of Default Judgment Against Defendants Bad Credit B Gone, LLC and Joseph A. Graziola, III is Granted).

[47] In three such cases, the Commission alleged that Experian, Equifax, and TransUnion failed to maintain adequate personnel to respond to consumer telephone disputes about their credit reports. *FTC v. Equifax Credit Info. Services, Inc.*, No. 00-0087 (N.D. Ga. 2000); *FTC v. Experian Mktg. Info. Solutions, Inc.*, No. 00-0056 (N.D. Tex. 2000); *FTC v. TransUnion LLC*, No. 00-0235 (N.D. Ill. 2000). More recently, the Commission alleged that Equifax had violated its consent decree and obtained another order requiring it to pay $250,000 in disgorgement. *United States v. Equifax Credit Info. Servs., Inc.*, No. 03-0087 (N.D. Ga. 2003). *See also United States v. Far West Credit, Inc.*, No. 06-00041 (D. Utah 2006) (CRA failed to use reasonable procedures to ensure accuracy).

[48] *United States v. ChoicePoint, Inc.*, No. 06-0198 (N.D. Ga. 2006).

ChoicePoint paid $10 million in civil penalties and $5 million in consumer redress.[49]

The Commission also has brought several recent cases against companies that allegedly furnished inaccurate information to CRAs. For example, the FTC alleged that a number of furnishers reported inaccurate dates for delinquent accounts, with the result that the adverse information remained on the consumers' reports for more than the seven-year limit provided under the FCRA.[50] Finally, the Commission has brought numerous cases against credit report users for failing to provide compliant "adverse action" notices to consumers as required by the FCRA. For example, in 2004 the Commission brought actions against two casinos that did not provide notices to job applicants whose employment was denied based in whole or in part on information contained in their credit reports.[51] And the Commission obtained nearly $1.5 million in combined penalties from Sprint and AT&T to settle charges that they failed to notify certain applicants for telephone service that they took adverse actions based on the consumers' credit reports.[52]

B. Consumer Education

In an effort to empower consumers to avoid harm, the FTC has developed extensive consumer education programs concerning financial services. The Commission has published more than fifty credit-related educational brochures for consumers; topics range from abusive

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[49] *United States v. ChoicePoint, Inc.*, No. 06-0198 (N.D. Ga. Feb. 15, 2006) (Stipulated Final Judgment and Order for Civil Penalties, Permanent Injunction, and Other Equitable Relief).

[50] *FTC v. NCO Group, Inc.*, No. 04-2041 (E.D. Pa. 2004); *United States v. DC Credit Services, Inc.*, No. 02- 5115 (C.D. Cal. 2002); *United States v. Performance Capital Mgmt., Inc.*, No. 00-1047 (C.D. Cal. 2000).

[51] *United States v. Imperial Palace, Inc.*, No. 04-0963 (D. Nev. 2004).

[52] *United States v. AT&T Corp.*, No. 04-04411 (D.N.J. 2004); *United States v. Sprint Corp.*, No. 04-00361 (N.D. Fla. 2004).

lending practices to secured credit cards to fair debt collection. The FTC also has educated the public about consumer protection developments, such as the right to obtain free credit reports once per year since 2004-05; over 52 million consumers have obtained their free reports through the new system.

In fiscal year 2006, the FTC distributed more than 4.1 million printed copies of financial education brochures, including identity theft publications, in both English and Spanish; "hits" on the FTC's Website for the same materials exceeded 6.2 million. And the FTC has focused on educating young people who have limited experience with credit, by conducting outreach on college campuses, at local districts' college fairs, and in high schools nationwide. Here in the District of Columbia, the Commission works to educate high school students, providing presentations about the responsible use of credit. The FTC continues to participate in the governmental Financial Literacy and Education Commission, contributing its expertise to subcommittees that produced MyMoney.gov and "Taking Ownership of the Future: The National Strategy for Financial Literacy."[53]

Moreover, the FTC distributes public service announcements and press kits, and Commission officials regularly conduct interviews on credit issues with representatives of local and national radio, television, and print media, in both English and Spanish. The agency also engages in other specialized outreach. For example, last September, in partnership with the Department of Justice's ("DOJ") U.S. Trustee Program, the FTC issued its "Consumer Credit Briefcase," a mini-CD with downloadable publications on credit issues. The FTC sent copies of

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[53] In addition, each April, the FTC participates in Financial Literacy Month. Activities include presentations to students on the importance of responsible credit card use and safeguarding personal information, and exhibits at Financial Literacy Day on Capitol Hill, where agency representatives distribute free consumer education materials.

the CD to more than 300 U.S. Trustee-approved credit counseling organizations to share with clients.

C. Research and Policy Development

The FTC engages in broad-based research and policy development work concerning financial services. Public workshops, in which we examine emerging issues, are valuable tools that we use to assist in policy development. Most recently, we held a public workshop regarding the role of identity authentication in preventing identity theft.[54]

In May 2006, the Commission sponsored a workshop in which government regulators, industry participants, consumer advocates and others explored the consumer protection issues raised by increased availability and use of nontraditional mortgage products.[55] The workshop focused primarily on the benefits and risks of two types of alternative mortgage products: interest-only ("I/O") hybrid-rate loans[56] and payment option adjustable rate mortgages ("option ARMs").[57]

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[54] *See* Public Workshop, Proof Positive: New Directions for ID Authentication, 72 Fed. Reg. 8381 (Feb. 26, 2007); *see also* http://www.ftc.gov/bcp/workshops/proofpositive/index.shtml. The transcript of this workshop is available at the Office of the Secretary to the Commission or at http://www.ftc.gov/bcp/workshops/proofpositive/index.shtml. *See also* Public Workshop, Rebate Debate (Apr. 27, 2007), information available at http://www.ftc.gov/bcp/workshops/rebatedebtate/index.shtml; Public Workshop, Negative Options: An FTC Workshop Examining Negative Option Marketing (Jan. 25, 2007), information available at http://www.ftc.gov/bcp/workshops/negativeoption/index.shtml.

[55] *See* Protecting Consumers in the New Mortgage Marketplace, 71 Fed. Reg. 15,417 (Mar. 28, 2006); *see also* http://www.ftc.gov/bcp/workshops/mortgage/index.html. The transcript of this workshop is available at the Office of the Secretary to the Commission or at http://www.ftc.gov/bcp/workshops/mortgage/transcript.pdf.

[56] I/O loans provide for an initial loan period during which borrowers pay only the interest that is accruing on the loan balance; hybrid-rate I/O loans carry a fixed interest rate and payment for an introductory period, generally one to ten years, and then become variable-rate loans for the remainder of the loan's term.

[57] Option ARMs generally offer borrowers the following choices about how much they will pay each month during the loan's introductory period: (1) a minimum payment amount that is smaller

Using information learned at the alternative mortgages workshop, the FTC filed comments with the Federal Reserve Board ("Board") regarding the "Home Equity Lending Market,"[58] in September 2006.[59] In its comment, the Commission noted that it can be difficult for consumers to obtain and compare information about the costs and terms of different mortgage products. Moreover, for more complex loans – such as nontraditional mortgages – consumers face further challenges in understanding all significant terms and costs. It is therefore critical that consumers obtain all of the relevant information needed to make an informed choice at each stage of the mortgage process. Obtaining this information at the loan closing may be too late for many consumers.[60] In the Commission's law enforcement experience, even when presented, the mortgage disclosures mandated by TILA and RESPA are complex, difficult to understand, and laden with technical terms.

The Commission has just announced results of a study that confirms the need to improve mortgage disclosures.[61] Various parties have advanced proposals for improvements to federally required mortgage disclosures for many years; specifically, Congress directed the Board and

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than the amount of interest accruing on the principal; (2) the amount of interest accruing on the principal; or (3) the amount of principal and interest due to fully amortize the loan on a 15-year or 30-year payment schedule.

[58] 71 Fed. Reg. 26,513 (May 5, 2006).

[59] FTC, COMMENT TO FEDERAL RESERVE BOARD ON HOME EQUITY LENDING MARKET (Sept. 14, 2006), *available at* http://www.ftc.gov/os/2006/09/docketop-1253commentfedreserve homeeqlenditextv.pdf.

[60] For example, in refinancings, consumers receive certain TILA disclosures about the costs and terms of their loans "before" consummation – which usually occurs at closing. *See* 12 C.F.R. §§ 226.17(b), 226.18.

[61] FTC, BUREAU OF ECONOMICS STAFF REPORT, JAMES M. LACKO AND JANIS K. PAPPALARDO, IMPROVING CONSUMER MORTGAGE DISCLOSURES: AN EMPIRICAL ASSESSMENT OF CURRENT AND PROTOTYPE DISCLOSURE FORMS (June 2007).

HUD to simplify and improve disclosures and create a single disclosure form.[62] The Board and HUD provided to Congress formal recommendations for mortgage disclosure reform in 1998.[63]

Building on such prior work, the Commission's Bureau of Economics ("BE") conducted a study of mortgage lending disclosures that examines how consumers search for mortgages, how well consumers understand current mortgage cost disclosures and the terms of their own recently obtained loans, and whether better disclosures could improve consumer understanding of mortgage costs, consumer shopping for mortgage loans, and consumers' ability to avoid deceptive lending practices. The BE research included thirty-six in-depth interviews with recent mortgage customers, and quantitative testing with over 800 mortgage customers to explore their understanding of mortgage costs and terms disclosed in both current forms and a prototype disclosure form developed for the study. Through the study, BE found: (1) the current federally required disclosures fail to convey key mortgage costs to many consumers; (2) better disclosures can significantly improve consumer recognition of mortgage costs; (3) both prime and subprime borrowers failed to understand key loan terms when viewing the current disclosures, and both benefitted from improved disclosures; and (4) improved disclosures provided the greatest benefit for more complex loans, for which both prime and subprime borrowers had the most difficulty understanding loan terms. The study also suggests that, in actual market transactions, subprime borrowers may face even greater difficulties understanding their loan terms than found in the

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[62] Economic Growth and Regulatory Paperwork Reduction Act of 1996 (Pub. L. 104-208, 110 Stat. 3009), Section 2101.

[63] Joint Report to the Congress Concerning Reform to the Truth in Lending Act and the Real Estate Settlement Procedures Act (July 1998). Moreover, an earlier BE study addressed mortgage broker compensation disclosures. FTC, BUREAU OF ECONOMICS STAFF REPORT, JAMES M. LACKO AND JANIS K. PAPPALARDO, THE EFFECT OF MORTGAGE BROKER COMPENSATION DISCLOSURES ON CONSUMERS AND COMPETITION: A CONTROLLED EXPERIMENT (Feb. 2004), *available at* http://www.ftc.gov/os/2004/01/030123mortgagefullrpt.pdf.

study, and may benefit the most from improved disclosures. The study results are consistent with the FTC's view that consumer testing often is critical in the development and evaluation of consumer disclosures. The Commission would be pleased to work with the Board and HUD as they work on improving mortgage disclosures.

IV. FTC COOPERATION WITH OTHER REGULATORS

The FTC has coordinated regularly on financial practices matters with federal banking agencies, DOJ, and HUD. The FTC also has engaged in cooperative efforts with many state attorneys general and state banking departments to protect consumers.

A. Joint Law Enforcement Actions

The Commission historically has sought to work with other federal agencies, and with state law enforcement officials, on law enforcement activities. For instance, working primarily with HUD, the FTC secured the $40 million settlement with mortgage servicer Fairbanks Capital Corp., discussed above.[64] In the *Fairbanks* case, as well as in other subprime mortgage lending cases, the FTC's cooperation with HUD enabled the agencies to bring strong cases combining allegations under the laws the FTC enforces – the FTC Act and TILA – with allegations under the Real Estate Settlement Procedures Act, which HUD enforces.[65] Moreover, the Commission has led numerous credit-related "sweeps" in which federal and state law enforcers target credit scams and announce cases together to leverage resources and enhance deterrence.[66]

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[64] *United States v. Fairbanks Capital Corp.*, No. 03-12219 (D. Mass. 2003).

[65] *See United States v. Mercantile Mortgage Co.*, No. 02-5079 (N.D. Ill. 2002); *United States v. Delta Funding*, No. 00-1872 (E.D.N.Y. 2000); *see also United States v. Shawmut Mortgage*, No. 93-02453 (D. Conn. 1993).

[66] *See, e.g.*, FTC Press Release, *"Project Credit Despair" Snares 20 "Credit Repair" Scammers* (Feb. 2, 2006), *available at* http://www.ftc.gov/opa/2006/02/badcreditbgone.shtm; FTC Press Release, *FTC, States Give "No Credit" to Finance-Related Scams in Latest Joint Law Enforcement*

B. Coordination and Training

A centerpiece of the FTC's law enforcement efforts to combat fraud is the Consumer Sentinel database. The database contains thousands of consumer complaints made directly to the FTC or made to other agency and institutional partners. It is available for use by other law enforcers, about 1700 of which have taken advantage of this resource. Recently the agency has begun discussions with numerous federal and state counterparts (such as the Office of the Comptroller of the Currency ("OCC") and the Conference of State Bank Supervisors) about how to better cooperate in sharing consumer complaints. Because each agency has jurisdiction over different types of entities, it is important that each consumer complaint reach the proper law enforcer. A working group composed of representatives of these various agencies currently is discussing how to improve the sharing of complaints. It also is exploring the possible development of a standard complaint form that could be used to facilitate information sharing among law enforcers.

The Commission and its staff also regularly lend their expertise in consumer protection to other agencies. On a regular basis, for example, Commission staff members speak at training conferences of the Federal Reserve Board and the Federal Deposit Insurance Corporation ("FDIC"), helping to educate examiners and others on the front lines about acts and practices that are unfair and deceptive. In 2006, the Commission held a debt collection workshop, bringing together state regulators and law enforcers to enhance cooperation in cracking down on debt collection abuses. As another example, in 2003 and 2004, the FTC and the American

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Sweep (Sept. 5, 2002), *available at* http://www.ftc.gov/opa/2002/09/opnocredit.shtm; FTC Press Release, *FTC Acts to Stop Fraudulent Credit Card Protection Offers* (Sept. 14, 1999), *available at* http://www.ftc.gov/opa/1999/09/ccppress.shtm.

Association of Residential Mortgage Regulators sponsored three law enforcement summits, through which federal, state, and local officials worked together to combat unfair and deceptive practices in the mortgage lending market.

C. Coordination on Regulatory and Policy Efforts

For more than a decade, the FTC has been a member of the Interagency Task Force on Fair Lending, a joint undertaking with HUD, DOJ, and the banking regulatory agencies. The purpose of the task force is to work together to prevent lending discrimination and predatory lending. The Task Force has published a Policy Statement on Lending Discrimination,[67] and meets frequently to discuss fair lending policy and enforcement issues. Task Force members also share information about developments in the law and marketplace and trends in consumer complaints.

The FTC further has worked collaboratively with federal banking agencies to develop and update regulations to reflect statutory and marketplace changes. In the last several years, the agency has worked extensively on joint rulemakings under the Fair and Accurate Credit Transactions Act of 2003 ("FACTA") and GLB. For example, under FACTA, the FTC has worked jointly with the Board, FDIC, OCC, Office of Thrift Supervision ("OTS"), and National Credit Union Administration to propose guidelines for financial institutions and creditors to identify patterns of activity that indicate possible identity theft.[68]

In addition, the FTC has worked for the past several years with the banking agencies and the Securities and Exchange Commission on an extensive consumer research project aiming to

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[67] *See* Notice of Approval and Adoption of "Policy Statement on Discrimination in Lending" and Solicitation of Comments Regarding its Application, 59 Fed. Reg. 18,266 (Apr. 15, 1994).

[68] See Joint Notice of Rulemaking, 71 Fed. Reg. 40,786 (July 18, 2006).

develop a model privacy notice for financial institutions that consumers can understand and use. The agencies hired a research firm to do consumer testing to develop a model notice and released a report detailing the research process and the model notice in March 2006.[69] Last fall, Congress enacted a law directing certain federal agencies to propose a model form that financial institutions can use as a legal safe harbor.[70] On March 29, the agencies published a notice of proposed rulemaking, proposing as the model form the privacy notice developed in the consumer research project.[71] The agencies expect to complete the project by the end of 2007.

Moreover, the Commission has provided comments and testimony to the Board regarding various issues relating to mortgage lending.[72] Indeed, the FTC and other federal agencies have collaborated several times to submit joint comments on key financial services issues.[73] The FTC

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[69] *See* Kleinmann Commc'n Group, Inc., Evolution of a Prototype Financial Privacy Notice, Inc. (Feb. 28, 2006), *available at* http://www.ftc.gov/opa/2006/03/jointprprivacy.shtm.

[70] *See* Financial Services Regulatory Relief Act of 2006, § 728, Pub. L. No. 109-351, 120 Stat. 1966 (Oct. 13, 2006).

[71] Interagency Proposal for Model Privacy Form Under the Gramm-Leach-Bliley Act and Notice of Proposed Rulemaking, 72 Fed. Reg. 14,940 (Mar. 29, 2007), *available at* http://www.ftc.gov/opa/2007/03/jointrelease.shtm.

[72] *See, e.g.*, FTC Comment on Federal Reserve Board Notice Regarding the Home Equity Lending Market (Sept. 14, 2006), *available at* http://www.ftc.gov/os/2006/09/docketop-1253commentfedreservehomeeqlenditextv.pdf; FTC Comments on Proposed Amendments to Regulation Z, Implementing the Home Ownership and Equity Protection Act (Mar. 9, 2001), http://www.ftc.gov/be/v010004.shtm; Prepared Statement of the Federal Trade Commission before the Board of Governors of the Federal Reserve System on Predatory Lending Practices in the Home-Equity Lending Market (Sept. 7, 2000), *available at* http://www.ftc.gov/os/2000/09/predatorylending.htm.

[73] *See* Joint Comment of Dep't of the Treasury ("Treasury"), DOJ, HUD, OTS, OCC, the Small Business Administration ("SBA"), and the Office of Federal Housing Enterprise Oversight Regarding Regulation B (Nov. 29, 1999); Joint Comment of Treasury, DOJ, HUD, OCC, OTS, and SBA on Regulation B (June 2, 1998); Joint Comment of Treasury, DOJ, HUD, OCC, and OTS on Regulation C (June 2, 1998).

has submitted testimony before state legislatures on financial services issues as well.[74]

V. CONCLUSION

Protecting consumers of financial services from harm is an important and growing priority for the Commission. The FTC will continue to target deceptive and unfair practices by actors in the financial marketplace and currently devotes significant resources and attention to deceptive mortgage advertising, mortgage servicing abuses, fair lending enforcement, unlawful debt collection, deceptive payment card marketing, and unlawful student loan practices.

Law enforcement works best when government officials work together. The Commission therefore is continually improving its coordination with its federal and state law enforcement counterparts. In particular, the agency currently is focusing on ways to more effectively share complaints and other relevant information.

The Commission's financial practices agenda extends beyond law enforcement to encompass research and policy development. Specifically, in light of the numerous and rising yearly complaints we receive about debt collectors, this year the Commission is undertaking a major initiative to examine the changes in that industry and explore their impact on consumers and businesses, including through a debt collection workshop in October 2007.

The Commission will continue to be a strong advocate for consumers on financial services issues. The FTC will implement its active, positive agenda to protect consumers in the financial services marketplace, and it will build on its pre-existing relationships with federal and state regulators. The Commission appreciates your consideration of its views.

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[74] *See, e.g.*, Prepared Statement of the Federal Trade Commission before the California State Assembly Committee on Banking and Finance on Predatory Lending Practices in the Home-Equity Lending Market (Feb. 21, 2001), *available at* http://www.ftc.gov/be/v010002.shtm.

Testimony of Thomas J. Miller

Attorney General of Iowa

Before the House Committee on Financial Services

June 13, 2007

"Improving Federal Consumer Protection in Financial Services"

I. Introduction

CHAIRMAN FRANK AND MEMBERS OF THE COMMITTEE:

Thank you very much for inviting me to testify before you today. The issues you are addressing in today's hearing are vital to American consumers. The most expensive purchases consumers ever make are their homes and vehicles. The majority of consumers finance these purchases and today many consumers finance with federally-chartered lenders. It is essential that government possess and exercise the authority to act against all lenders who engage in deceptive or unfair practices in connection with consumer loans or the other financial products or services offered by lenders.

The Supreme Court has provided guidance in its ruling in *Watters v. Wachovia* concerning whether state agencies may engage in visitation oversight of national banks and their operating subsidiaries. The answer was in the negative. However, the Court left open a number of questions regarding the degree to which national banks and their operating subsidiaries remain subject to state enforcement for violations of state consumer protection laws. Regardless of the ultimate answers to those questions, the need for federal-state cooperation in the context of ensuring national banks and their subsidiaries treat consumers fairly and are held responsible for violations of state and federal consumer protection laws in this consumer driven economy could never be greater.

In your invitation, you asked that we highlight our thoughts on the role the states can continue to play in working with federal regulators to provide additional resources and expertise in monitoring and enforcement in the consumer protection realm. In my view, we have a great opportunity to work together with the OCC, the OTS and other federal agencies to ensure

American consumers have their complaints heard and addressed, and that nationally-regulated financial institutions comply with the consumer protection laws.

I intend on addressing six keys issues in my testimony:

1) Handling consumer complaints;
2) Establishing a joint federal/state task force to address predatory subprime lending practices;
3) Establishing a continuing federal/state working relationship to address all other issues;
4) Being more aggressive about rooting out bad conduct by federally-regulated financial institutions;
5) Holding national banks accountable when they knowingly facilitate consumer fraud; and,
6) Enacting federal predatory lending legislation consistent with other federal laws that authorize enforcement by state officials.

II. The offices of state attorneys general are a tremendous resource for resolving individual consumer complaints; both national banks and consumers would benefit from our assistance

Taking and handling consumer complaints is a primary function of the offices of state attorneys general. Collectively, we have almost 700 full time investigators and attorneys enforcing compliance with state and some federal consumer laws. Conversely, the OCC has 17 times fewer personnel to look into consumer complaints.[1] While the states have been taking complaints and enforcing consumer protection laws for decades, it is only within the past seven years that the OCC has determined it can enforce the deception and unfair practices standards of the FTC Act against national banks.[2]

The states, the District of Columbia, and the territories strongly publicize their complaint-handling services to consumers and make those services available locally. Due, in part, to this

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[1] Committee on Financial Services, 108th Cong., *Views and Estimates on Matters to Be Set Forth in the Concurrent Rs. On the Budget for Fiscal Year 2005,* at 16 (Comm. Print 2004), available at: http://financialservices.house.gov/media/pdf/FY2005%20Views_Final.pdf.

[2] Julie L. Wiliams and Michael S. Bylsma, "On the Same Page: Federal Banking Agency Enforcement of the FTC Act to Address Unfair and Deceptive Practices by Banks," 58 Bus. Lawyer 1243, 1244 (May, 2003).

publicity, I believe consumers are many times more likely to turn to their state Attorney General for assistance with a consumer complaint than they are any federal agency. I think this is particularly true for federally-chartered financial entities that are regulated by various agencies with which most citizens are unfamiliar. In addition, because of our greater collective resources and experience handling consumer complaints, we believe we can handle consumer complaints more quickly and efficiently than can the OCC and other federal financial regulators.

This increased visibility, efficiency and speed benefits the financial institutions which are the subject of the complaints as much as it benefits consumers. If a complaint can be handled and resolved more quickly and efficiently, it lessens the likelihood of expensive litigation or the necessity of pursuing a foreclosure in the context of mortgage lending.

Policy reasons also support permitting states to handle consumer complaints against federally-chartered institutions. The States' interests are particularly acute when it comes to mortgage lending complaints. The borrowers reside in our neighborhoods and cities. The effects of predatory loans are inherently local, with local and state governments bearing the brunt of the costs when neighborhoods fail. Simply put, the states have a greater need to expedite complaint-handling of mortgage lending complaints – and this benefits lenders as much as it does borrowers.

Other federal agencies which regulate industries where states have been preempted from bringing enforcement action provide a possible model of how the OCC and other financial regulators can work with us to assist consumers. For example, the states are preempted under the FAA Act from pursuing lawsuits against airlines for deceptive advertising, but the FAA has never instructed airlines to refuse to work with us or respond to consumer complaints. Indeed,

the airlines have traditionally worked with us to deal with individual complaints, despite the clear preemption. Without agreeing that the *Watters* decision clearly preempts states from enforcing consumer protection laws against national banks, I would like to see the states develop a similar relationship with the federal agencies that oversee federally-chartered financial institutions. For example, the OCC should encourage national banks to respond to our offices when complaints are filed and work with us to resolve those complaints when it appears the OCC's involvement would be beneficial to resolving the matter. The OCC should not tell banks to ignore our offices or be non-responsive. All parties involved should favor fair and efficient resolution of complaints.

III. The OCC and other federal financial regulators should work with the states to establish a joint federal/state task force to continue pursuing predatory subprime lending practices

Everyone has a strong interest in ensuring that lenders, regardless of their charter, avoid engaging in predatory lending practices. The States' settlements with Household and Ameriquest helped lead the way in the fight against predatory mortgage lending practices. Those cases were pursued through joint efforts by state attorneys general and state banking regulators. The States' attorneys general have developed substantial expertise in identifying and acting against deceptive mortgage lending practices. In today's subprime environment, the states retain substantial authority. With its extraordinary authority, the OCC and the states together can effectively set standards that all lenders will have to follow. Together with the OCC's jurisdiction and authority over national banks, we can do even more to eliminate fraud in connection with mortgage lending.

The offices of the attorneys general have worked effectively for many years with other federal agencies, such as the FTC, in taking action against national companies in areas such as: consumer privacy, telemarketing violations, motor vehicle lease advertising by national lenders, and various other areas. These actions resulted from the establishment of good ongoing working relationships between the staffs of our offices and of the federal agencies involved. These joint working relationships have included sharing information about potential violations and conducting joint investigations and joint prosecutions, or dividing prosecutions with the federal agencies handling some cases and the states others.

This unified approach results in greater deterrence. Indeed, the exponential power of a federal/state task force to chill bad practices cannot be overstated. The need is greatest when it comes to predatory mortgage lending practices. Consumers victimized by predatory lending face financial ruin and even the potential loss of shelter. Regulators need to send a strong, unified message to all mortgage lenders that the practices we discovered at Household and Ameriquest cannot be repeated.

By setting strong standards at the national level as to federally-chartered institutions, we can continue to send a strong message to lenders that borrower abuses, whether in the field of mortgage or other lending, will not be tolerated and will have severe consequences. Indeed, the potential loss of a federal charter would be a substantial deterrent.

The attorneys and investigators in the offices of state attorneys general have developed substantial expertise in dealing with fraudulent lending practices. I believe that we have much to offer to federal regulators and look forward to working with them.

IV. The States and federal regulators should establish a continuing relationship to address issues beyond predatory mortgage lending

The States regularly receive complaints that may involve some level of participation by national banks. Routine conversations between OCC attorneys and leading States' assistant attorneys general would further the OCC's knowledge and understanding about practices which run afoul of state consumer fraud laws. There currently exists no such exchange of information or knowledge between the attorneys general and the OCC.

As discussed above, the states have long worked with the Federal Trade Commission on an ongoing basis in a number of areas. For example, the states and the FTC have regular conference calls to discuss problems with spam e-mails. We routinely share information about a host of other consumer issues. The FTC recognizes the fact that simply because a company does business nationally, this does not mean state attorneys general have no role to play in enforcement. The FTC recognizes that most of the companies our constituents deal with on a daily basis as consumers are parts of national or international corporations and that our state laws and enforcement authority apply to these companies. However, we don't need the OCC to agree with us as to our jurisdiction in order to work with them in information sharing, conducting investigations or otherwise assisting in enforcement actions against national lenders. All we need is a willingness on behalf of the OCC, the OTS, and other federal regulators to work with us.

Federally-chartered financial institutions provide a variety of financial services. The states could assist the federal agencies in identifying cases of deceptive and unfair practices concerning motor vehicle or home improvement lending, credit card advertising and billing,

failure to disclose extra fees and material limitations on gift cards issued by national banks, maintaining privacy of consumers' financial information, and others. These problems have been seen as to federally-chartered financial institutions, but there has been little or no federal action. The states can assist the OCC and the other federal agencies to decrease or solve many of these problems.

We also need to ensure that the federal agencies have the necessary authority to act against deceptive and unfair practices against national banks. We can't have the Supreme Court seemingly remove the states as enforcers of state laws and leave a toothless OCC as the only remaining regulator. We plan to conduct a thorough review of the OCC's authority and to suggest expanding that authority, if necessary.

V. Federal banking regulators need to be more aggressive about rooting out bad conduct by the institutions they regulate

The OCC has brought few enforcement cases against national banks for engaging in deceptive or unfair practices.[3] Conversely, the states have filed hundreds of lawsuits over the decades alleging violations of state UDAP laws against a variety of businesses, including national financial firms. The *Watters* decision makes it imperative that the OCC change course and become much more aggressive about identifying and acting against deceptive practices.

For example, state attorneys general have investigated and settled with several national banks concerning their marketing agreements with companies offering "free trial offers" to consumers for non-banking products. The most recent case was a multistate settlement with

[3] From a list currently appearing on the OCC's website, it appears the agency has concluded six enforcement actions against banks for unfair or deceptive practices, with its first being in 2000. See: http://www.occ.treas.gov/Consumer/Unfair.htm

Trilegiant Corporation and Chase Bank. Trilegiant mailed misleading solicitations to consumers with small checks, typically for $2 to $10, that many consumers mistakenly thought were a rebate or some kind of reward. But cashing the checks committed consumers to a 30-day "trial offer" in some kind of membership program or buying club – and then to monthly or annual charges if they didn't cancel. The states' investigation found that Trilegiant had agreements with Chase Bank to gain access to Chase's customers and market the membership programs. Trilegiant used Chase's name in mailings, and Chase reviewed and approved marketing materials. The States acted to stop these practices and protect consumers. It is important to note that the complaints the states received didn't necessarily name the national bank as the complained-against party. It was through the states' investigation that the bank was identified as being involved. The OCC has not acted to deter national banks from engaging in conduct such as this.

The states have also investigated deception in connection with the issuance of Visa and MasterCard gift cards by national banks.[4] The materials accompanying the cards did not adequately disclose non-usage fees and other limits imposed on card holders. Again, the OCC had taken no action against the banks, and consumers suffered for this lack of action.

In addition, national banks have been charging excessive fees to levy on bank accounts to satisfy child support obligations. Iowa law limits this fee to $10. However, the OCC has claimed national banks are exempt, a position with which Iowa strongly disagrees for many reasons. This has allowed national banks to charge fees in excess of $100. For example, in one situation there was $118 in the account when the levy was issued, the national bank charged a

[4] The mall gift card referred in the following linked documents was issued by a national bank. http://www.oag.state.ny.us/press/2005/mar/Consent%20Order%20and%20Judgment.pdf

levy fee of $125, which resulted in the child getting nothing and the delinquent parent incurring even more debt. In these situations the child and parent lose while the national banks continue to profit. Not only has the OCC not acted against this practice, it seemingly has endorsed it!

If the OCC arguably remains the "only cop on the beat" as to national banks, it simply must step up to the plate. It must work harder to identify ways in which national banks are mistreating consumers and act to deter that conduct. Reviewing a bank's safety and soundness is no longer enough. With our substantially greater expertise in identifying and remedying deceptive and unfair practices, state attorneys general stand ready to assist the OCC in such an effort.

VI. Federal banking regulators must hold banks accountable when they knowingly facilitate consumer fraud

The OCC should not permit national banks to continue avoiding responsibility when they are used by telemarketing and Internet scam artists to extract money from the bank accounts of senior citizens and other vulnerable consumers. National banks know something is wrong when payment rejection rates are higher than normal. Unfortunately, despite this knowledge, some banks continue to do business with criminals. The OCC needs to make it crystal clear to national banks that they will be audited on the degree to which they ensure they are not made conduits for those who wish to harm consumers.

The *New York Times*, in its front page story of Sunday, May 20, 2007, described how telemarketing scam artists, operating outside the U.S., depend on support from data brokers and banks to complete their crimes against Americans. The data brokers help them at the outset by selling them victim lists. The banks help them complete the scheme by processing "demand

drafts" – unsigned checks, created after the scam artists trick the victims into divulging their bank account numbers. By accepting these demand drafts when there is clear indicia of fraud, banks are helping these criminals drain the life savings of vulnerable consumers in our states and throughout the country.

In the *New York Times* story, it was reported that Wachovia Bank, a national bank, "accepted $142 million of unsigned checks from companies that made unauthorized withdrawals from thousands of accounts. . . . [and] collected millions of dollars in fees from those companies, even as it failed to act on warnings, according to records." That story also noted that Wachovia ignored requests from other banks to stop processing demand drafts on behalf of an individual the other banks reported was defrauding consumers, and ignored a return rate of near 60%.

According to the OCC's website, two of its four primary objectives are:

- To ensure the safety and soundness of the national banking system.
- To ensure fair and equal access to financial services for all Americans.

Given the prevalence of fraud in the use of demand drafts, based on our own experience and as reported in the *Times*, the OCC is falling short of ensuring the "safety" of the banking system and "fair access" to financial services. It is neither "safe" nor "fair" to permit national banks to facilitate the efforts of fraud merchants to extract money from the bank accounts of consumers who are little able to absorb the losses when the banks know or reasonably should know that will likely be the outcome.

State attorneys general and the FTC have been doing their part to fight telemarketing fraud directed into our states from outside U.S. borders by taking action against companies that facilitate the scams. Examples include actions against companies that process electronic

withdrawals through the Automated Clearing House[5] and state-chartered banks that similarly assist these frauds.[6] It is well past time for the OCC to use its extraordinary leverage to force national banks to cease helping criminals steal from vulnerable victims.

VII. Congress should consider passing effective federal predatory lending consistent with other federal laws that enable enforcement by state attorneys general

In recent years Congress has enacted several consumer protection laws that authorize enforcement by state attorneys general as well as by federal authorities, including laws relating to credit repair,[7] credit reporting agencies,[8] telemarketing fraud,[9] children's online privacy,[10] home owner's equity protection,[11] and a variety of others. Joint enforcement in these areas has worked well.

While banks may not have caused the current subprime crisis, setting national standards levels the playing field and helps to ensure fair competition. State attorneys general are anxious to contribute our thoughts on national standards that protect consumers and foster strong competition in mortgage lending. I believe that enabling us to enforce such a law, in addition to federal enforcement, will result in far greater compliance.

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[5] http://www.state.ia.us/government/ag/latest_news/releases/dec_2005/Teledraft.html; and http://www.state.ia.us/government/ag/latest_news/releases/feb_2005/Electracash.html

[6] http://www.state.ia.us/government/ag/latest_news/releases/july_2005/First_Premier.html

[7] 15 U.S.C. section 1679h

[8] 15 U.S.C. section 1681s

[9] 15 U.S.C. section 6103

[10] 15 U.S.C. section 6504

[11] 15 U.S.C. section 1640(e)

VIII. Conclusion

It pains me to say that the *Watters* decision provides us with an opportunity to start anew, in that I strongly disagree with the policy of preempting states from regulating state-chartered entities that are operating subsidiaries of national banks that conduct business and commit violations of consumer protection laws in the states. However, the reality we face is that the *Watters* decision has raised new challenges for state regulation and enforcement and, therefore, now is the time to call on federal regulators to substantially step up their efforts. They asked for this situation and they can do more. The states will be watching closely. In addition, the states stand willing to assist as best we can to help ensure that our constituents are not harmed by the actions of national banks.

Again, thank you very much for inviting my testimony on this extremely important issue. I and my colleagues around the country look forward to working with this Committee as it considers ways to improve federal consumer protection in financial services.

Bio for Iowa Attorney General Tom Miller

Attorney General Tom Miller is serving in his seventh four-year term as Attorney General of Iowa.

Miller was born in Dubuque, Iowa, and he graduated from Loras College and Harvard Law School. He served as a VISTA volunteer in Baltimore, worked as a legislative assistant to U.S. Rep. John Culver, and served in the Baltimore Legal Aid Bureau. He moved back to Iowa in 1973, opened a law practice in McGregor, and served as city attorney from 1973 to 1979.

General Miller has been Attorney General of Iowa since he was first elected in 1978, except for four years in private practice. He established the nation's first farm division in an Attorney General's office and has earned a reputation for being a very strong consumer protection advocate. He has been a leader of multi-state actions and working groups on tobacco issues, antitrust enforcement, agriculture, and consumer protection.

General Miller has served as President of the National Association of Attorneys General and has chaired NAAG's Consumer Protection, Insurance, Antitrust, and Tobacco committees. He currently is Co-chair of NAAG's Financial Practices Committee.

General Miller was one of the leaders among the attorneys general in the landmark tobacco case and 1998 Master Settlement Agreement. He was the lead attorney general in the Microsoft case, and he led the multi-state investigations and negotiations that resulted in settlements with Household International, Inc., and Ameriquest Mortgage Company. In the Household Finance case, the settlement in 2003 resulted in $484 million in consumer restitution nationwide -- the largest direct restitution ever in a state or federal consumer case. In the Ameriquest Mortgage case, the settlement reached last year resulted in Ameriquest making sweeping reforms of its lending practices and paying $325 million, including $295 million in restitution to consumers.

[END]

Embargoed until
June 13, 2007, at 10:00 am

Statement of

Scott M. Polakoff, Senior Deputy Director
Office of Thrift Supervision

concerning

Improving Federal Consumer Protection in Financial Services

before the

Committee on Financial Services
United States House of Representatives

June 13, 2007

Office of Thrift Supervision
Department of the Treasury

1700 G Street, N.W.
Washington, DC 20552
202-906-6288

Statement required by 12 U.S.C. 250: The views expressed herein are those of the Office of Thrift Supervision and do not necessarily represent those of the President.

Testimony on Improving Federal Consumer Protection in Financial Services
before the
Committee on Financial Services
United States House of Representatives
June 13, 2007

Scott M. Polakoff, Senior Deputy Director
Office of Thrift Supervision

I. Introduction

Good morning, Chairman Frank, Ranking Member Bachus, and Members of the Committee. Thank you for the opportunity to present the views of the Office of Thrift Supervision (OTS) on issues related to the adequacy of existing consumer protections in financial services. Consumer protection, maintaining the safety and soundness of the thrift industry, and ensuring the continued availability of affordable housing credit are the three primary responsibilities of the OTS. The first of these, effective consumer protection, requires four important components.

First, effective consumer protection requires an emphasis on consumer protection issues both in the examination and in the application process. The application process enables us to screen applicants and/or proposed operating strategies that undermine our ability to maintain and enforce sound consumer protections. The examination process enables us to identify and monitor potential or actual threats to consumer protection as they arise. We conduct comprehensive examinations every 12-18 months (depending on thrift asset size). In between regularly occurring exams, we engage in off-site monitoring. This includes following-up on any issues raised during previous examinations and monitoring for changes in products, management, or services.

Second, an effective supervisory program is necessary to address threats to consumer protection. In our experience, this requires the use of formal and informal enforcement actions, depending on the situation and when the circumstances warrant the exercise of this authority.

Third, effective consumer protection by a regulator requires a robust consumer complaint mechanism to address issues as they arise. This involves timely and effective handling of consumer issues with the regulated entity that is the subject of the complaint. It also requires using the information collected in the complaint process to improve consumer protection monitoring, oversight and enforcement of regulated institutions and the industry. For example, our consumer complaint staff helps to identify trends that may suggest the need for industry guidance, as well as issues to be addressed during on-site examinations.

Fourth, a sound consumer protection program requires effective training and continuing education of examiners, including all supervisory and compliance staff regarding consumer protection issues. An important aspect of this is educating and training the institutions and industry regarding new or emerging consumer protection issues and trends. Such communication and training helps facilitate strong overall compliance risk management systems and controls

within the thrift industry, which is our goal and the best approach – to address potential problems before they arise.

A critical aspect of the OTS's consumer protection program is ensuring that our authority is clear and unambiguous to the entities that we regulate; that the industry that we regulate understands the laws and consumer protection standards under which we expect them to operate; and that we consistently apply these laws, rules and standards to all segments of the industry, including institution holding companies and affiliates that are within our jurisdiction.

In my testimony today, I will discuss the thrift charter and an overview of thrift powers and statutory limits under the Home Owners' Loan Act (HOLA), OTS authority and oversight of the thrift industry, our consumer protection program, and our consumer outreach activities and programs.

II. Overview of Thrift Powers and Statutory Limits under the HOLA

Pursuant to the Home Owners' Loan Act (HOLA), thrifts must maintain 65 percent of their assets in residential mortgages, home equity loans, education loans, small business loans, and credit card loans.[1] This requirement is referred to as the qualified thrift lender, or QTL, test. The purpose of the QTL test is to encourage a focus on mortgage and certain other lending activities by thrifts. This benefits consumers by increasing competition for these types of lending services and promotes asset diversification and balance in thrift operations by avoiding an over-reliance and overexposure to a limited and narrowly focused lending strategy.

Thrifts originate almost a quarter of all residential mortgages, and residential mortgage investments account for two-thirds of all thrift assets. In order to support the ability of federal thrifts to operate on a nationwide basis, federal thrifts are permitted to operate under a uniform federal scheme that promotes an open and competitive mortgage market, reduces the cost of financing a home, and enhances the ability of thrifts to provide other efficient and economical financial services in their communities.

To ensure the uniformity required to conduct nationwide mortgage lending activities, the HOLA and OTS implementing regulations, adopted after full public notice and comment rulmaking, permit federal thrifts to conduct their core operations, including lending, deposit-taking, and trust activities, subject only to the requirements of federal statutes and regulations.[2] OTS lending, deposit, and trust regulations identify areas in which federal thrift operations are subject only to federal requirements, and also identify the areas in which state laws apply to a federal thrift. The latter include state contract, tort, and criminal laws, and other laws that further a vital state interest and either have only an incidental effect on thrift operations or are not otherwise contrary to the purposes of enhancing safety and soundness and enabling federal thrifts to operate according to best practices.

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1. 12 U.S.C. § 1467(m).

2. 12 C.F.R. §§ 560.2, 557.11-557.13, 550.136, and 545.2.

III. OTS Authority and Oversight of the Thrift Industry

The HOLA establishes that the OTS Director shall provide for the "examination, safe and sound operation, and regulation of savings associations."[3] The HOLA further authorizes the OTS Director to charter, examine, and regulate federal thrifts "giving primary consideration of the 'best practices' of thrift institutions in the United States."[4] Pursuant to this authority, the OTS has adopted regulations that establish a uniform framework governing the operations of federal thrifts. These regulations include the application and review of, and examination for compliance with, consumer protection laws applicable to thrifts, including federal consumer protection statutes and OTS rules, regulations and standards. We believe our existing statutory authority to examine thrift institutions for compliance with consumer protection issues is adequate and allows for a broad range of enforcement authority that we have and will continue to exercise, as described later in this statement.

The courts have routinely interpreted the "best practices" standard as providing the OTS (and its predecessor, the Federal Home Loan Bank Board) wide and exclusive latitude with respect to overseeing the operations of federal thrifts, including the organization and structure, and lending and deposit-taking activities. The 1982 Supreme Court case, *Fidelity Federal Savings & Loan Association v. de la Cuesta*, is the seminal case interpreting the HOLA's authority over federal thrifts.[5] Reciting legislative history dating to the original enactment of the HOLA in 1933, the Court noted that "Congress plainly envisioned that federal savings and loans would be governed by what the [federal thrift regulator]—not any particular State—deemed to be the 'best practices.'" The Court went on to observe that "the statutory language suggests that Congress expressly contemplated, and approved, the [agency's] promulgation of regulations superseding State law." Numerous federal courts have followed the Supreme Court's 1982 decision and the Court has continued to affirm it as good precedent.

Following the Court's ruling in 1982, the Federal Home Loan Bank Board adopted a rule in May 1983, after full public notice and comment, codifying that the HOLA and its implementing regulations are the exclusive law governing the operations of federal thrifts.

Pursuant to these authorities, the OTS regularly examines thrifts for safety and soundness and compliance with over thirty federal consumer protection statutes and regulations, including the Equal Credit Opportunity Act, the Fair Housing Act, and the Truth in Lending Act. In addition, as described later in this statement, we examine for compliance with our regulations that prohibit discrimination and misrepresentations in advertising. We also examine to ensure compliance with other consumer protection guidelines, such as interagency guidance on subprime lending.

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3. 12 U.S.C. § 1463(a).

4. 12 U.S.C. § 1464(a).

5. Fidelity Federal Savings & Loan Association v. de la Cuesta, 458 U.S. 141 (1982). The Court upheld a federal regulation permitting federal thrifts to include due-on-sale clauses in mortgage contracts.

We also expect responsible lending practices by our regulated lenders that have a subprime lending program. Our examiners focus on various issues in this regard, including:

- Whether institution marketing materials are well designed to present the typical consumer with adequate information to help them make informed product choices;
- Whether institution sales practices – either through loan officers or third parties – may tend to mislead a consumer about the nature and scope of a credit transaction or may impose pressure on consumers to accept terms and conditions based on incomplete or unbalanced information;
- Whether institution employee training programs, including training provided to third party vendors that interact with institution customers, foster best practices; and
- Whether existing institution practices may have the effect of steering particular groups of consumers to less favorable credit products or higher cost credit products than their credit risk profile warrants.

IV. OTS Consumer Protection Program

A. OTS Examination, Monitoring and Oversight

OTS has a comprehensive examination structure that is unique among the federal banking agencies. This program, which has been in place for approximately four years, combines our safety and soundness and compliance examinations to better assess institution risks during the examination process. We have found that it also improves the assessment of risk within the industry and provides examiners with a broader examination perspective as well as broader developmental opportunities. And from a regulatory burden perspective, it is less intrusive to our institutions to have a combined safety and soundness and compliance exam, than to have two separate exams every exam cycle.

Part of the underlying rationale for this comprehensive examination approach is that we believe compliance and safety and soundness should go hand in hand at an institution. We believe this provides a more comprehensive assessment of an institution's risk profile and more accurately exposes weaknesses and deficiencies in an institution's overall program. Examining an institution's compliance with consumer protection laws and regulations along with its overall safety and soundness also provides us with an accurate assessment of an institution's overall business strategy, and management's ability to manage risk relating to safety and soundness as well as compliance, across the organization.

Our safety and soundness and compliance examiners are subject to an intensive cross-training program to acquire the full knowledge and skills needed to perform comprehensive examinations. We also maintain a cadre of compliance specialists and managers that serve as subject matter experts to assist examination teams in handling complex compliance issues. OTS has significantly increased our examination and supervisory staff. Over the last year and a half, we have hired over 100 examiners and supervisory staff. Additionally, we have re-established a centralized compliance function in Washington, DC to provide direction and policy regarding various compliance issues. In addition, our program staff has produced combined examination procedures, policies and handbook manuals that support this comprehensive examination

approach. The majority of responses from institutions have been overwhelmingly favorable regarding this examination format.

As set forth in OTS examination guidance,[6] OTS examiners look at a broad range of issues to assess safety and soundness and compliance issues. For example, examiners evaluate the following areas during the assessment of an institution's lending program:[7]

- subprime lending, marketing and servicing activities;
- credit scoring models used by thrifts to set applicable rates and fees;

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6. Section 218, OTS *Examination Handbook.*

7. In addition, OTS examiners assess thrift's compliance with all of the following federal consumer protection laws highlighted in the OTS Examiner Handbook:

- Fair Lending/General OTS Nondiscrimination Requirements (Section 1200)
- Equal Credit Opportunity Act (Section 1205)
- Fair Housing Act (Section 1210)
- Home Mortgage Disclosure Act (Section 1215)
- Fair Credit Reporting Act (Section 1300)
- Truth in Lending Act (Section 1305)
- Restitution (Section 1310)
- Real Estate Settlement Procedures Act (Section 1320)
- Homeowners Protection Act (Section 1323)
- Consumer Leasing Act (Section 1325)
- Electronic Fund Transfer Act (Section 1330)
- Expedited Funds Availability Act (Section 1335)
- Check 21 (Section 1336)
- Flood Disaster Protection Act (Section 1340)
- Right to Financial Privacy Act (Section 1345)
- Fair Debt Collection Practices Act (Section 1350)
- Unfair and Deceptive Acts or Practices (Section 1355)
- Homeownership Counseling (Section 1360)
- Truth in Savings Act (Section 1365)
- Electronic Banking (Section 1370)
- Privacy of Consumer Financial Information (Section 1375)
- Insurance Consumer Protection (Section 1380)
- Bank Secrecy Act (Section 1400)
- Bank Protection Act (Section 1405)
- Equal Employment Opportunity Act (Section 1410)
- Interest on Deposits (Section 1420)
- Advertising (Section 1425)
- Branch Closing (Section 1430)
- Community Reinvestment Act (Section 1500)
- Disclosure and Reporting of CRA Related Agreements (Section 1505)
- Bank Secrecy Act Anti Money Laundering (Interagency FFIEC BSA/AML Manual)
- Suspicious Activity Reporting (Interagency FFIEC BSA/AML Manual)
- OFAC Compliance ((Interagency FFIEC BSA/AML Manual)
- OTS Mortgage Regulations (12 CFR § 560.210)

- the existence of any unfair or deceptive acts or practices in the marketing or servicing of lending products or deposit accounts;
- compliance with Truth in Lending Act disclosure requirements;
- loan collections and workout activity;
- delinquency, classifications, and charge-off policies;
- institution risks and controls (including fraud control) with respect to lending activities;
- underwriting and account acquisition standards; and
- general account management and servicing procedures.

Compliance assessments are part of every comprehensive examination, which occur every 12 to 18 months based on asset size. OTS examiners also conduct targeted compliance reviews as warranted. For example, we assess institutions' Home Mortgage Disclosure Act data, and follow-up with special field visits if we identify potential issues or concerns that require additional examination. In such cases we conduct targeted "fair lending" exams that may occur outside of the regular examination schedule. In addition, if we identify issues or concerns during an examination that require the institution to take steps to address our concerns, examiners may go back on-site to ensure that the institution has complied with our directions. Close supervision also enables us to direct thrifts to ensure that strong consumer protection and compliance programs are in place, help us identify potential unfair acts or practices, steer clear of predatory lending practices, and if we identify concerns, to quickly implement needed reforms.

Because federal thrifts may conduct their lending and deposit-taking programs subject only to the requirements of federal law, the OTS is required to ensure that federal thrifts conduct their activities and programs in compliance with applicable consumer protection laws and subject to rigorous scrutiny of all aspects of an institution's program. In conducting its oversight of federal thrifts, the OTS is particularly mindful of consumer protection and reputation risks that could undermine the safety and soundness of an institution and/or the federal thrift charter.

As part of our examinations, we regularly examine thrifts for compliance with federal consumer protection statutes including the Truth in Lending Act, the Home Ownership and Equity Protection Act, the Real Estate Settlement Procedures Act, the Truth in Savings Act, the Equal Credit Opportunity Act, the Fair Housing Act, and the Fair Credit Reporting Act. We also examine for compliance with our advertising regulation, which prohibits thrifts from making any representation that is inaccurate or that misrepresents its services, contracts, investments or financial condition.[8] In addition, we examine thrifts for compliance with our nondiscrimination regulation, which prohibits thrifts from discriminating in lending and other services, appraisals, marketing practices and related areas.[9] Finally, long-standing OTS guidance provides that a thrift's collection activities must comply with the following:

- state laws that pertain to collection and foreclosure actions; and

8. 12 C.F.R. § 563.27.

9. 12 C.F.R. Part 528.

- bankruptcy law – an institution's collection activity is affected by any bankruptcy plan into which a debtor has entered.

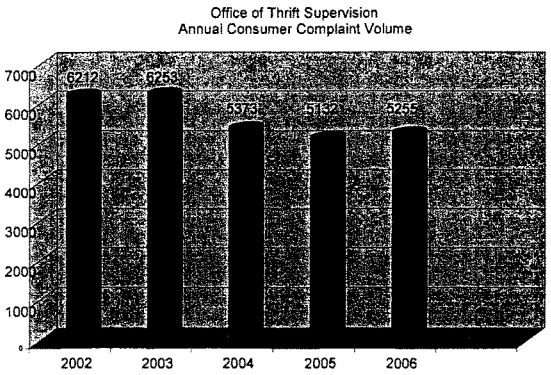
We also closely monitor industry credit card practices, particularly programs evidencing universal default characteristics and/or double-cycle billing. Another area of particular scrutiny with respect to credit card management practices is the application of minimum amortization standards by credit card lenders. Pursuant to guidelines issued by the federal banking agencies, credit card lenders are expected "to require minimum payments that will amortize a current loan balance over a reasonable period of time, consistent with the unsecured, consumer-oriented nature of the underlying debt and the borrower's documented creditworthiness."[10] In our examinations and oversight, we look closely to identify interest rate adjustment features, billing practices, prolonged negative amortizations, inappropriate fees, and other practices that inordinately compound or protract consumer debt and disguise portfolio performance and quality.

B. Consumer Complaint Activity

The OTS continually tracks, investigates and responds to consumer complaints involving thrift institutions with respect to loan and deposit product offerings and services. Consumer complaint staff and managers also prepare summaries of consumer complaints for OTS examiners to utilize in their reviews during on-site examinations.

Institution consumer complaint records are an integral part of the OTS examination process. This data plays a significant role in identifying areas for examiners to focus on during on-site examinations. These records also play a critical role in assessing the adequacy of an institution's overall compliance management program and in pursuing corrective action that may be appropriate to address programmatic weaknesses or deficiencies.

In addition to using consumer complaint data in connection with the supervisory oversight and examination of an institution, the OTS follows up with the institution on all consumer complaints filed with the agency. We impose a 60-day timeframe for the handling of consumer complaints by OTS staff and, in order to meet that goal, we work with thrifts promptly to request information needed to process and resolve a



10. Interagency Credit Card Lending, Account Management and Loss Allowance Guidance, January 8, 2003.

complaint. Due to the complexity of some complaints and related factors, it is not always possible to resolve a complaint within the designated timeframes; however, we track our response time closely. We typically process and conclude consumer complaint investigations within our designated timeframes. From January 2005 through May 2007, OTS staff processed and closed 94 percent of all consumer complaints we received within the designated 60-day timeframe.

It is important to note that our consumer complaint policy provides that even when evidence does not reveal regulatory violations, OTS complaint analysts and management have the flexibility and authority to encourage thrifts to take voluntary action to satisfy a consumer, where circumstances warrant such action. This happens fairly frequently in the interest of preserving strong customer relationships and further enhancing the reputation of thrifts as essential providers of financial services.

The OTS has not shared consumer complaint information regarding specific institutions with consumers or members of the public. However, we are in the process of a comprehensive analysis and review of our consumer complaint function. Standard reports regarding consumer complaint volume and trends is one of the issues we are evaluating. In order to ensure that we are responsive to consumers that contact us regarding complaints against thrift institutions, OTS Consumer Affairs staff, managers and often senior management invest a significant amount of time through personal interactions via phone, e-mail and sometimes meetings with consumers. We also engage our Ombudsman Office to follow-up with consumers who have a complaint or concern regarding a thrift institution.

C. Coordination with State and Federal Regulators

The OTS has extensive experience coordinating with state regulators. We have cooperation and information sharing agreements with 49 state insurance regulators and the District of Columbia. These agreements provide for the sharing of regulatory information where an affiliation exists or is proposed between a savings association or holding company regulated by the OTS and an insurer regulated by a state entity. The agreements also contain provisions to allow and facilitate the referral and sharing of consumer complaint information. The agreements ensure that state insurance regulators address consumer complaints and inquiries relating to insurance activities and that the OTS addresses complaints and inquiries relating to thrift activities. In addition, the agreements further ensure that both state regulators and the OTS are fully informed as to the resolution of all consumer complaints.

We also recently finalized with the Conference of State Bank Supervisors (CSBS) a model memorandum of understanding (MOU) that we will use to implement operating agreements with various state banking supervisors to facilitate the sharing of consumer complaint data between the OTS and the states. While the OTS and state banking departments have forwarded consumer complaints to each other for many years, the MOU further facilitates and formalizes this process and is intended to ensure that consumer complaints are promptly forwarded to the appropriate regulator for processing. The model MOU also provides for periodic reports of the number of complaints forwarded to the states or the OTS, the disposition of such complaints and related summary information. We have been working closely with the CSBS on this effort for several

months, and we are looking forward to working with individual state banking departments to put implementing agreements in place.

OTS also actively participates in the "Consumer Financial Protection Forum," a program launched by the Treasury Department in March of 2006 to focus exclusively on financial consumer concerns and to provide a permanent forum for communication between federal and state regulators on key and emerging consumer protection issues. The Forum is chaired by the Treasury Department and participants include the federal banking and credit union regulators, the Federal Trade Commission, and representatives from state supervisory organizations.

The Forum provides a mechanism for sharing information about patterns of abuse, including emerging trends and ongoing problems at financial institutions that are subject to federal or state supervision. One key topic Forum members have discussed is consumer complaint information, including ways federal and state banking agencies can coordinate. This includes a review of how consumer complaints are handled by the participating agencies and suggestions as to how those processes can be improved.

The OTS and the other banking agencies have also been sharing information and best practices through annual interagency conferences, including one scheduled for this fall. Additionally, the OTS, the other federal banking agencies and CSBS have initiated a discussion to explore the creation of a uniform consumer complaint form. The OTS supports this initiative as we believe the creation of a single form will simplify and clarify the process for consumers. We also believe creation of such a form will facilitate the sharing of consumer complaint data among federal and state banking agencies.

We believe that all of these coordination activities are critical steps to ensure timely information exchange, identify problematic issues, and resolve consumer protection concerns. We will continue to participate in such initiatives.

D. OTS Enforcement Authority and Activities regarding Consumer Protection

When an institution's lending programs are found to be potentially predatory or lacking adequate controls to support responsible lending, there are numerous options that the OTS can take to stop these practices and correct the situation. These include formal enforcement actions and informal agreements. Our jurisdiction and oversight of an institution's lending programs also extends to the holding companies, affiliates, service providers, and other contractual relationships that an institution may utilize.

For example, just last week we announced the execution of a significant formal supervisory agreement to address and remedy problems created by a subprime lending program that was conducted out of a thrift affiliate. Our action against the thrift was based on its failure to manage and control in a safe and sound manner the loan origination services outsourced to its affiliate. Our supervisory agreement required the institution to identify and provide timely assistance to borrowers who were negatively affected by the loan origination and lending practices of the thrift's affiliate and who are at risk of losing their homes in foreclosure.

Pursuant to the supervisory agreement, a reserve of $128 million was established to cover costs associated with providing affordable loans to borrowers whose creditworthiness was not adequately evaluated when their loan was originated and to reimburse borrowers who paid large broker fees or lender fees at the time of the origination. In addition, the institution agreed to increase the reserve if the costs of remediation efforts turn out to be higher than initially estimated and, in fact, the reserve has already been increased by another $35 million. Finally, the institution and its affiliates committed to donate another $15 million to be used for financial literacy programs and credit counseling.

In another case involving an institution with a high level of customer complaints regarding potentially abusive servicing practices, OTS examiners were sent to the institution to review the institution's lending practices and program. Pursuant to that review, the institution was directed to implement adequate policies to address and resolve various unacceptable lending practices. When the institution failed to address these issues in a timely manner, the OTS initiated an enforcement action against the thrift.

The institution signed a written Supervisory Agreement with the OTS in which it agreed to improve its compliance with the Real Estate Settlement Procedures Act, the Fair Debt Collection Practices Act and the Fair Credit Reporting Act. In addition, the institution agreed to create a "Consumer Ombudsman" responsible for "fairly and impartially reviewing and addressing [customers'] borrowing issues in a timely and effective manner." The agreement also required the development of borrower-oriented customer service plan/practices, and a consumer dispute resolution initiative plan among other things. It is also worth noting that approximately one year following the execution of the supervisory agreement, the OTS approved the institution's request for a "voluntary dissolution".

In two other cases, similar results were achieved. Using a combination of formal and informal enforcement actions, the agency forced the discontinuation of lending operations by two federally chartered thrifts based on poorly supervised lending activities. In both cases, subprime lending programs that exhibited abusive features coupled with lax management oversight controls were effectively terminated. A significant concern by the OTS staff was an effort by both institutions to attempt to exploit the charter to engage in lending programs lacking adequate consumer protections and management controls.

In one of these cases, OTS staff shut down a program that utilized brokers to do out-of-state lending activities that were lacking sound consumer protections and controls. The agency's directive to the institution concluded that the activity was tantamount to a charter rental strategy intended to avoid State and OTS oversight of out-of-state lending activities by the institution.

We also impose conditions requiring responsible lending policies and barring abusive practices by an institution, its holding company and affiliates at the time of an acquisition. Typically, these types of conditions are appropriate where we know or have reason to believe that an acquirer plans to start or continue an existing subprime lending program at a newly acquired or *de novo* institution. Whenever such conditions are imposed, regional staff will work closely with and monitor the institution and its holding company/affiliates to ensure that adequate controls are imposed and maintained in connection with the subprime lending program.

There are numerous other such examples of actions taken by the OTS in the course of examinations of the institutions we regulate. While we find informal actions to be an effective mechanism to address these types of supervisory concerns, we do not hesitate to use our formal enforcement authority when appropriate to do so. Fundamental to our continuing oversight of the industry we regulate is ensuring that institutions conduct their activities in a manner consistent with sound consumer protection.

E. OTS Examiner Consumer Compliance Test

Pursuant to our program for monitoring and oversight of consumer protections, the OTS recently developed a new examination that is used to test and train OTS examiners regarding their level of proficiency across a broad range of consumer compliance laws and regulations. While we have always tested our examiners in this area, we developed this in-house examination to continue to ensure that OTS examiners have significant knowledge regarding consumer compliance requirements and agency expectations of the institutions that we regulate. The new test will assist us in working with our examiners to develop professionally to effectively examine thrift institutions, many of which have complex, retail-focused business models.

V. OTS Consumer Outreach Activities and Programs

A. Consumer Education and Informed Financial Services Decisions

The OTS has worked on its own and cooperatively with various other agencies and organizations to promote consumer education and responsibility. We also have various initiatives to improve financial literacy and we work closely with our institutions to encourage them to do the same.

1. The CHARM Booklet

One interagency initiative involved working closely with the Federal Reserve Board to assist consumers in navigating their choices among mortgage products. The product of that effort, a consumer disclosure brochure entitled the Consumer Handbook on Adjustable Rate Mortgages – or CHARM booklet, was revised and re-released on December 26, 2006. The CHARM booklet provides information to consumers about the features and risks of ARM loans, including the potential for payment shock and negative amortization. It is tailored to help consumers better understand some of the issues and potential pitfalls with newer loan products

In particular, the CHARM booklet was substantially revised to address the growing use of NTM and newer types of ARM products that allow borrowers to defer payment of principal and sometimes interest. For example, it includes information for consumers on both "interest-only" and "payment option" ARMs. The revised booklet describes how these loans typically work, demonstrates how much (and how often) monthly payments could increase, and describes how a loan balance can increase if only minimum monthly payments are made. The booklet, which is a required consumer disclosure for ARM loans, also includes a mortgage shopping worksheet to help consumers compare the features of different mortgage products.

2. The Interest Only-Pay Option Mortgage (IO-POM) Brochure

The OTS also contributed to the development of an interagency consumer informational brochure addressing interest-only and payment option mortgages. This brochure describes payment shock and negative amortization. The brochure supplements interagency illustrations the federal banking agencies recently finalized on nontraditional mortgage products. The illustrations were intended to help financial institutions implement the consumer protection section of the Interagency Guidance on Nontraditional Mortgage Products, adopted by the federal banking agencies on October 4, 2006. The finalized illustrations, which are not mandatory, were published in the Federal Register on June 8, 2007.

3. The OTS Consumer Complaint Brochure

In connection with our agency-wide program for National Consumer Protection Week in February, the OTS issued a consumer information brochure on how consumers can resolve complaints with financial institutions. That brochure highlights various steps that consumers can take in order to attempt to resolve a complaint. First, consumers are encouraged to try to resolve a problem directly with an institution by contacting senior management or the institution's consumer affairs department. If this is unsuccessful, consumers are advised to contact the appropriate OTS regional office for institutions regulated by the OTS or, if the entity is not OTS-regulated, the guidance provides information for identifying the appropriate federal and/or state regulator for various types of financial institutions. Finally, the brochure reminds consumers that the best way to pursue a complaint or concern is to make sure that it is well documented.

4. Gift Card Guidance and Consumer Information Brochure

The OTS issued a consumer information brochure and separate industry guidance on the purchase and use of gift cards. The brochure, entitled "Consumer Fact Sheet: Buying, Giving, and Using Gift Cards," advises consumers regarding gift cards issued by financial institutions. In particular, the brochure highlights various issues to consider when buying and using gift cards. These include:

- checking gift card program terms and conditions regarding limits on where a card can be used, and whether it can be used for online shopping;
- being aware of any applicable expiration dates;
- understanding fees, including fees imposed for inactivity or non-use of a gift card, processing fees for purchasing the card, monthly maintenance fees, and fees that may apply if the card can be used to obtain cash from an ATM;
- determining whether a gift card can be replaced if it is lost or stolen, and what conditions apply to replacement, including whether a fee is imposed;
- checking on whether a gift card can be used in connection with another payment method if the purchase amount exceeds the available balance on the card;
- checking on fees imposed to inquire about the remaining balance on a card; and
- evaluating other gift card features, such as whether the card may be reloaded, whether there is a fee for this, and fees imposed on cash redemption features,

The OTS brochure also reminds consumers regarding the importance of card security, including asking a sales clerk to verify the stored amount when a card is purchased, and remembering that a gift card should be treated the same as cash. Finally, the brochure provides general advice on addressing problems and how to resolve complaints about a gift card.

The OTS also issued a CEO letter to federal thrifts on February 26, 2007 entitled "Guidance on Gift Card Programs." We often use CEO letters to communicate to the institutions we regulate regarding supervisory guidance and our supervisory expectations. In the guidance, we emphasized the importance of effective account administration, marketing and consumer disclosure practices. In particular, we indicated that "OTS expects savings associations to ensure that consumers receive appropriate and pertinent information about gift card products such as principal features, applicable fees, and expiration dates."

With respect to consumer protection considerations, the guidance informed institutions that we expect them to avoid use of promotional materials that could mislead a reasonable consumer about the terms, conditions or limitations on the associations' gift card programs. Further, we provided specific recommendations relating to types of disclosures our institutions should provide including: (i) where the consumer can use the gift card; (ii) the expiration date of the gift card; (iii) the amount of service, maintenance, shipping and handling and other fees as applicable; (iv) how a consumer can check or track his or her balance; and (v) policies governing lost or stolen gift cards.

We emphasize that sound and effective disclosures will provide consumers with information to understand and consider the cost, fees, terms, features and risks of purchasing a gift card product. We also stress that the content and format of disclosures should promote consumer understanding and usability. In this regard, we expect institutions to use plain language, clear and conspicuous font, and bold headings when describing gift card programs and features.

5. OTS's National Consumer Protection Week Program

The OTS Consumer Complaint brochure was part of a 5-day series of consumer protection and awareness initiatives during National Consumer Protection Week. During the week of February 5, 2007, the OTS also highlighted various issues for thrift institutions and resources available to consumers on financial literacy and education via press releases. We also noted that the agency's five day National Consumer Protection Week program was part of a wider agency initiative intended to bolster OTS efforts to assist institutions in working with their customers to improve financial literacy and education. And it is part of an ongoing effort to upgrade substantially the agency's own compliance, consumer protection and consumer awareness programs.

An important aspect of the OTS's efforts to upgrade our own consumer awareness and protection programs is monitoring emerging trends and evolving financial products in order to develop appropriate guidance for institutions and resources that assist consumers in making informed financial decisions. As we stressed before the Financial Literacy and Education Commission (FLEC) earlier this year, financial literacy and education is equally important to institutions and the customers they serve.

During National Consumer Protection Week, we also issued a press release reminding consumers about the risks presented by identity theft and steps to guard against it. The release highlighted for consumers their right to take advantage of a free credit report from the major credit reporting agencies pursuant to the Fair Credit Reporting Act.

We noted that careful credit report monitoring not only helps consumers obtain credit at rates commensurate with their credit history, it also helps to guard against identity theft. We also encouraged all of the institutions we regulate to work with their customers to increase awareness of the importance of periodically monitoring their credit report. We reminded consumers that credit scores largely determine the cost they pay to receive loans and that over time, a consumer's ability to pay lower interest rates to a lender because of a positive credit score can save them lots of money. We also noted that insurance companies and employers also utilize information from credit reports, stressing how important it is for all of us to know what's in our credit reports.

B. OTS National Housing Forum

At the National Housing Forum (NHF) sponsored by the OTS in December 2006, another issue affecting the subprime mortgage market was highlighted. The NHF included a panel on mortgage fraud that featured an important discussion on the impact of mortgage fraud on financial institutions and borrowers. The panel discussion highlighted the fact that regulated institutions reported over a $1 billion in losses from mortgage fraud in 2005. And reports of suspected mortgage fraud doubled in just three years from 2003 to 2006.

The panel discussion noted that mortgage fraud can be divided into two broad categories – fraud for property and fraud for profit. Fraud for property generally involves misrepresentations or omissions designed to deceive the lender into extending a mortgage. Fraud for profit, frequently committed with the complicity of industry insiders, involves fraudulent appraisals, property flipping, straw borrowers, and identity theft. Fraud for profit frequently involves large schemes, concocted by sophisticated criminals. This is an important point in the context of the current discussion and, unfortunately, one that is not easily quantifiable with respect to the impact on subprime borrowers.

While lenders and consumers have benefited significantly from lower interest rates and a mortgage boom the past several years, higher loan volumes have encouraged lenders to develop ways to cut costs and create efficiencies in the mortgage underwriting process. And the recent moderation in housing has added pressure to exploit these efficiencies in order to capture demand while retaining profits. It is certainly true that mortgage lending innovations have produced efficiencies that are good for lenders and borrowers. Yet, while such innovations have made borrowing easier and more user-friendly, they have also provided opportunities for fraud to proliferate. This is an ongoing issue of concern to the OTS and all participants in the mortgage markets.

C. OTS Community Outreach Activities/Partnership Building

Another important aspect of OTS efforts to combat predatory lending is a community outreach program that includes designated community affairs liaisons – known as CALs – in each of our regional offices. OTS CALs conduct various regional outreach efforts to help identify community credit and banking needs, and match those needs and opportunities with our regulated thrifts. Over 30 new community contacts were established in 2006 to complement our many existing community-based partners. Such partners include financial institutions, government agencies, community based organizations, non-profit groups, and social service agencies. Our CALs address and work on affordable housing and economic development needs, best practices for serving emerging markets, elder financial abuse issues, financial literacy programs, and other initiatives targeted at low- to moderate-income individuals and communities.

Regional programs, organizations and forums in which OTS CALs and other OTS employees are involved include a Boston New Alliance Task Force in October 2006 addressing the unbanked and underbanked; two events in 2006 involving the New York New Alliance Task Force that involved outreach to community-based entities that cater to the needs of the unbanked and underbanked; a joint summit on financial fraud prevention in December 2006 sponsored by our Northeast Regional Office and the New England Consumer Advisory Council.

Other organizations that we worked with during 2006 include the Housing Leadership Council of San Mateo County, California; Lenders for Community Development, in San Jose, California; Coachella Valley Housing Coalition, Indio, California; the Fair Housing Councils of Riverside County, and Palm Springs, California; the San Francisco Housing Development Corporation; the San Francisco Planning and Urban Research (SPUR) Association; Los Angeles Neighborhood Housing Services; and the Clearinghouse for Affordable Housing CDFI.

We also worked closely to develop further relationships with nationally recognized community organizations such as the Greenlining Institute, the California Reinvestment Committee, and Operation HOPE. And we collaborated with our sister FBAs to co-sponsor three community development training events during 2006 – a National Community Reinvestment Conference, in Henderson, Nevada; the Greater Sacramento CRA Roundtable, in Sacramento, California; and "Exploring the Valley's Unbanked Opportunity," in Fresno, California.

We also assist in providing basic financial education training, such as to a class of graduating high school seniors in San Francisco, and providing financial education training at a low- to moderate-income community center in Palm Springs, California. And we plan various other financial education and literacy outreach events for the remainder of 2007.

VI. Conclusion

Pursuant to our existing authority under the HOLA and based on the record of consumer protection initiatives, programs, state and federal interagency coordination, and our enforcement record in this area, I believe that the OTS demonstrates a strong commitment to the principles of sound consumer protection.

Regarding the adequacy of our existing authority to address consumer protection issues and potential abuses that may arise going forward with the programs of OTS-regulated thrifts and their affiliates, I believe our authority is complete and adequate. I do not believe that additional statutory authority is necessary at this time for the OTS to continue effectively to supervise, regulate and enforce federal consumer protection laws – including prohibiting unfair and deceptive acts and practices – with respect to the activities of the thrift industry. At such time as a need should arise, I assure you that we will advise the Chair and Members of the Committee for legislative assistance to address any deficiency in our ability to supervise and/or respond to thrift acts or practices that pose consumer protection, safety and soundness, or other risks to the federal thrift charter.

Thank you for the opportunity to present the OTS's views on these important issues. I will be happy to answer your questions.

AUG 6 2007

RD/MB

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

August 3, 2007

The Honorable Barney Frank
Chairman
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

At the June 13 hearing on federal consumer protection issues in the Committee on Financial Services, several Committee Members expressed an interest in establishing a single point of contact for consumer complaints that would serve customers of all banking institutions. I agree that there is such a need, and believe the Federal Financial Institutions Examination Council (FFIEC) is an excellent forum for state and federal agencies to work together to develop a one-stop approach for consumers with complaints against banks or their affiliates.

The OCC recently launched a consumer-focused Web site for customers of national banks. The site includes an extensive list of frequently asked questions, information to help users determine if their financial institution is a national bank, and an online complaint form. A site based on this model, but expanded to include the capability to identify the supervisor of any banking institution, and direct inquiries and complaints to the appropriate supervisor, could serve as a one-stop shop for all banking consumers.

As a first step in that direction, I wrote to my FFIEC colleagues, and suggested that we consider this approach at the next meeting on September 13, 2007. I sense a willingness by all FFIEC members to support greater clarity and efficiency in this area, and I am hopeful that we can agree on a plan going forward. In the meantime, I invite you to look at the OCC's site, www.HelpWithMyBank.gov, and I look forward to working with the Committee as we refine and streamline the complaint process to ensure that consumers experiencing problems with their banking institutions are treated with the respect and attention they deserve.

Sincerely,

John C. Dugan
Comptroller of the Currency

NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

EXECUTIVE HEADQUARTERS
2301 McGee Street
Suite 800
Kansas City MO
64108-2662
voice 816-842-3600
fax 816-783-8175

GOVERNMENT RELATIONS
Hall of the States
444 North Capitol St NW
Suite 701
Washington DC
20001-1509
voice 202-624-7790
fax 202-624-8579

SECURITIES VALUATION OFFICE
48 Wall Street
6th Floor
New York NY
10005-2906
voice 212-398-9000
fax 212-382-4207

WORLD WIDE WEB
www.naic.org

June 12, 2007

The Honorable Barney Frank
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Spencer Bachus
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

RE: Improving Consumer Protections

Dear Chairman Frank and Congressman Bachus:

State Insurance Commissioners' core mission is consumer protection. We applaud the Committee looking into improving consumer protections in the financial services sector.

Although the Financial Services Committee does not normally focus on health insurance issues, we would like to share with you some examples of the negative effects of federal preemption of state regulation of health insurance. There are ongoing attempts to preempt beneficial consumer protections in other areas of insurance. As you look to expand consumer protections we urge caution in any attempts to preempt state consumer protection powers in other areas of insurance.

Last month State Insurance Commissioners were asked to testify before the Senate Special Committee on Aging and the House Ways and Means Subcommittee on Health regarding the deplorable marketing practices of some Medicare Advantage plans. These hearings illustrated some of the consumer problems that have been created by the federal preemption of state regulation of insurance in the Medicare Advantage market.

Prior to passage of the Medicare Prescription Drug Improvement Act (MMA) of 2003, states shared regulatory oversight over Medicare Advantage plans (formerly known as Medicare+Choice). However, upon enactment of the MMA, states lost all of their regulatory authority over Medicare Advantage plans, except for licensure and solvency, including the authority to set or regulate marketing and sales standards. The MMA also established the same limited boundaries of state regulation for Medicare Part D prescription drug plans. As a consequence, we are now seeing rampant problems in the marketing and sales of Medicare Advantage plans through overly aggressive practices by plans, agents and brokers in this market. States, consumer groups, and media outlets have reported that senior citizens are being victimized by abusive practices including misrepresentation, deceptive or inappropriate sales practices,

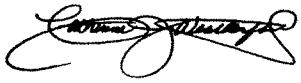
and in many instances, fraud. In Georgia, special agents for the state's insurance commissioner found insurance agents had signed up deceased individuals prior to enrollment period using the deceased individual's personal information which the agent had retrieved from insurance agency databases and Medicare Part D applications. North Carolina insurance investigators were investigating insurance agents who had switched residents of an assisted living community from traditional Medicare into private plans without their permission.

In the absence of the pre-emption imposed by the MMA, many of these abusive practices would be prohibited by state law, monitored and questioned by watchful state regulators, and controlled by the state regulatory structure. However, since these cases involve Medicare Advantage plans, or Medicare Part D plans, the hands of state regulators are often tied, as states are largely pre-empted. The marketing guidelines are established by the federal government, states are largely prohibited from monitoring the marketplace, and states have very limited ability to take corrective action against a company for misconduct. It has unfortunately become evident to states, lawmakers, and consumer advocates that the federal government does not have the expertise nor the manpower to adequately protect consumers in this area, and the negative consequences of the regulatory pre-emption for consumers is, at best, troubling.

In sharp contrast, Medicare Supplement (Medigap) insurance, which is monitored by effective state regulation, sees relatively few consumer complaints and no such widespread problems, even though it serves a similar population and is sold to seniors in a similar manner. In fact, several Congressional Committees are now looking to the state regulation of Medicare Supplement insurance as a potential template for remedying the problems with Medicare Advantage and Medicare Part D plans.

We would welcome the opportunity to work with the Committee to enhance state based consumer protections and enforcement through partnership, not pre-emption.

Sincerely,



Walter Bell
Alabama Insurance
Commissioner
NAIC President

Catherine J. Weatherford
NAIC Executive Vice President
and CEO

COMPARISON OF THE OCC'S PREEMPTION RULES WITH THE OTS'S AND NCUA'S CURRENT RULES

Types of State Laws Generally Preempted	OCC Rules	OTS Current Rules	NCUA Current Rules
Abandoned and dormant accounts (deposit-taking)	✓****	✓	✓
Aggregate amount of funds that may be lent on the security of real estate	✓*		
Checking/share accounts (deposit-taking)	✓	✓	✓
Covenants and restrictions necessary to qualify a leasehold as security property for a real estate loan	✓*		
Access to, and use of, credit reports	✓	✓	
Terms of credit	✓*	✓	✓
Creditor's ability to require or obtain insurance of collateral or other risk mitigants/credit enhancements	✓	✓	
Due-on-sale clauses	✓	✓	✓
Escrow, impound, and similar accounts	✓	✓	
Funds availability (deposit-taking)	✓	✓	
Interest rates	✓**	✓	✓
Fees	✓***	✓	✓
Licensing, registration, filings and reports	✓	✓	
Loan-to-value ratios	✓*	✓	✓
Mandated statements and disclosure requirements	✓	✓	✓
Mortgage origination, processing and servicing	✓	✓	
Disbursements and repayments	✓*	✓	✓
Savings account orders of withdrawal (deposit-taking)	✓	✓	
Security property, including leaseholds	✓	✓	✓
Special purpose saving services (deposit-taking)	✓	✓	

* Already preempted by the OCC's existing real estate lending regulation at 12 C.F.R. Part 34.

** National banks' authority to charge interest is established by 12 U.S.C. § 85, and the OCC's existing regulation at 12 C.F.R. § 7.4001.

*** National banks' authority to charge fees is already addressed by the OCC's existing regulations at 12 C.F.R. § 7.4002.

**** This does not apply to state laws of the type upheld by the United States Supreme Court in Anderson Nat'l Bank v. Luckett, 321 U.S. 233 (1944), which obligate a national bank to "pay [deposits] to the persons entitled to demand payment according to the law of the state where it does business." Id. at 248-249.

Types of State Laws Generally NOT Preempted	OCC Rules	OTS Current Rules	NCUA Current Rules
Contracts	✓	✓	
Commercial		✓	
Torts	✓	✓	
Criminal law	✓	✓	
Homestead laws specified by Federal statute	✓	✓	
Debt collection	✓		
Acquisition and transfer of real property	✓	✓	✓
Taxation	✓		
Zoning	✓		
Collections costs and attorneys' fees			✓
Plain language requirements			✓
Default conditions			✓
Insurance			✓
Incidental effect only	✓	✓	

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

July 20, 2007

Honorable Maxine Waters
House of Representatives
Washington, D.C. 20515

Dear Congresswoman Waters:

Thank you for the opportunity to respond to questions you submitted subsequent to my testimony on "Improving Federal Consumer Protection in Financial Services" before the Committee on June 13, 2007.

Enclosed is my response to those questions. If you have further questions or comments, please do not hesitate to contact me at (202) 898-6974 or Eric Spitler, Director of Legislative Affairs, at (202) 898-3837.

Sincerely,

Sheila C. Bair

Sheila C. Bair

Enclosure

Response to Questions from
The Honorable Maxine Waters

Q1. In your testimony, you suggest that a number of consumers are in "financial distress" because of the changes and choices in the financial services marketplace. Please explain to what extent is this financial distress a result of the complexity and ambiguity in the law, or is it a result of the differences between federal and state regulations?

A1. I believe that the distress affecting a number of consumers can be linked to several different, but related, factors. As I discuss more fully in my written testimony, advances in technology and changes in lending organization structure have resulted in financial products that are increasingly complex and marketed through increasingly sophisticated methods. The pace and complexity of these advances heighten the potential risk for consumer harm. Consumers today often face a bewildering array of choices, especially in the credit options available to them. For example, there are seemingly unlimited types of credit cards, each with its own particular terms and conditions. With regard to mortgages, consumers now have choices beyond the traditional fixed-rate mortgage, such as adjustable rate or nontraditional products that are tied to a variety of amortization schedules and arcane index rates. In many cases, it is difficult even for sophisticated consumers to fully understand the costs associated with particular credit options or to compare products effectively.

As consumers may not fully comprehend the terms of credit that has been offered to them, it is sobering to confront the fact that debt loads are increasing. Over the last 20 years, the ratio of total household debt to disposable personal income has more than doubled, climbing to more than 125 percent. Much of the rise in household debt is due to mortgage obligations.

The significant growth in debt loads for lower income consumers and for young people has been especially troubling. Many of these borrowers have accumulated debt obligations, often as a result of student loans or credit cards that put their financial health at risk even though the economy as a whole has experienced years of positive economic growth. In fact, data show that young adults today are more indebted than previous generations were at the same ages and appear less likely to make timely debt payments than other age groups. The average credit card debt held by young adults ages 18 to 24 and 25 to 34 grew by 22 percent and 47 percent, respectively, between 1989 and 2004.

To some extent, this increase in debt load is attributable to the extension of credit to borrowers who have not previously had access to it. Although the increased availability of credit is in many respects a positive development, the extension of credit to unsophisticated borrowers has created greater opportunities for abuse. These vulnerable consumers are more susceptible to sophisticated marketing that directs them to products that may not be the best for their needs -- or affordable in the long run.

Q2. Do consumers have adequate protections against predatory lending practices, e.g., subprime credit cards?

A2. While I support the operation of market forces, regulators need to set rules for market participation. Moreover, price competition does not work if consumers do not understand the true cost of financial products. Through appropriate rulemaking, regulators can establish strong protections for consumers that consistently guard against abuse across industry and supervisory lines. Meaningful enforcement authority and sufficient resources should be devoted to that authority.

With regard to credit cards, the Federal Reserve Board recently proposed amendments to Regulation Z, which implements the Truth in Lending Act. The notice of proposed rulemaking on Regulation Z contains significant advances in credit card disclosures. The proposed amendments would require important changes to the format, timing, and content requirements in documents provided to consumers throughout the life of a credit card account, including changes in solicitations, applications, account opening documents, change-in-term notices, and periodic billing statements. These proposed amendments will assist consumers in better understanding key terms of their credit card agreements such as fees, effective interest rates, and the reasons penalty rates might be applied, such as for paying late.

My written testimony describes additional proposals for improving consumer protections regarding credit cards and mortgage lending. I suggest that Congress consider the following reforms:

Create national standards for subprime mortgage lending by all lenders through either legislation or rulemaking under the Home Ownership and Equity Protection Act of 1994 (HOEPA). A statutory approach could draw from the 36 state anti-predatory mortgage laws currently in effect. At its core, however, a statutory framework should address two important areas: (1) the ability of the borrower to repay the loan; and (2) misleading marketing and disclosures that make it unnecessarily difficult for borrowers to fully understand the terms of loan products.

Expand rulemaking authority under Section 5 of the Federal Trade Commission (FTC) Act to all federal banking regulators to address unfair and deceptive practices. Under the FTC Act, the Federal Reserve Board, Office of Thrift Supervision, and the National Credit Union Administration have authority to issue rules regarding unfair or deceptive acts or practices for the institutions under their supervision. But the FTC Act does not give the FDIC authority to write rules that apply to the 5200 state non member banks that it supervises -- nor does it grant that authority to the OCC for its 1700 national banks. Although our examinations indicate that most FDIC-supervised banks are not engaging in predatory practices, the FDIC could more effectively address unfair and deceptive practices if we had rulemaking authority in this area. To effectively address predatory

lending, it may be necessary for Congress to provide rulemaking authority to a larger group of agencies.

Permit state Attorneys General and supervisory authorities to enforce the Truth in Lending Act (TILA) and the FTC Act against non-bank financial providers. To enhance enforcement of consumer protection laws, Congress could consider expanding TILA and the FTC Act to allow state Attorneys General, state banking regulators, and other appropriate state authorities to bring actions against non-bank financial service providers under these laws. State authorities now operate under their own anti-predatory statutes, but may not have the full ability to enforce federal standards. Expanding TILA and the FTC Act to incorporate non-bank financial service providers would give additional tools to state authorities, assist in maintaining minimum standards that apply to all financial service providers, and help provide a more level playing field for consumers and all lenders.

Provide funding for "Teach the Teacher" programs to provide better financial education. Integrating financial education into core public school requirements assures that students of all income levels are exposed to basic financial principles year after year. Some universities offer Teach the Teacher programs, which could benefit greatly from federal financial support.

Q3. What steps, if any, will the FDIC undertake to examine this issue? If none, when might FDIC begin the process of addressing this issue?

A3. The FDIC has taken a number of steps in these areas. In October 2006, the FDIC and other federal banking agencies issued *Guidance on Nontraditional Mortgage Product Risks*. Concerned that some borrowers may not fully understand the risks of nontraditional mortgage products, such as interest-only and payment option adjustable-rate mortgages, the agencies issued this guidance advising bank management of the potential for heightened risk levels entailed with offering these products. Institutions were strongly encouraged to ensure that consumers have sufficient information to clearly understand loan terms and associated risks prior to making a product or payment choice.

In June 2007, the FDIC and other federal banking agencies issued a *Statement on Subprime Mortgage Lending* that established consumer protection standards that should be followed to ensure that consumers, especially subprime borrowers, obtain loans they can afford to repay and receive information that adequately describes product features. The statement also encourages institutions to work constructively with residential borrowers who are in default or whose default is reasonably foreseeable.

In June 2007, the FDIC published final *Guidelines on Affordable Small-Dollar Loans*, which encourage FDIC supervised institutions to offer and promote these products to their customers. The goal is to enable banks to better serve an underserved and potentially profitable market while helping consumers avoid, or transition away from, reliance on high-cost debt.

As discussed in my answer to Question #2, I have suggested a number of other steps for Congress to consider that would provide additional protections to consumers. Opportunities exist to improve and expand the ability of the federal banking agencies to protect consumers. The FDIC stands willing to assist Congress and to join with our fellow regulators to explore ways to ensure a financial industry that is profitable for the institutions and fair to its customers.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

RANDALL S. KROSZNER
MEMBER OF THE BOARD

August 7, 2007

The Honorable Maxine Waters
House of Representatives
Washington, D.C. 20515

Dear Congresswoman:

I am pleased to enclose my responses to your additional questions following the June 13 hearing before the House Financial Services Committee regarding consumer protection. I have also forwarded a copy of my responses to the Committee for inclusion in the hearing record.

Sincerely,

Enclosure

Governor Randall S. Kroszner subsequently submitted the following in response to written questions received from Congresswoman Maxine Waters in connection with the June 13, 2007, hearing before the Committee on Financial Services:

Q.1. The Federal Reserve Board has sole responsibility for issuing rules to implement a number of consumer financial services and fair lending laws, including the Equal Credit Opportunity Act (ECOA) and the Home Mortgage Disclosure Act (HMDA).

- **Could you highlight for us what you consider to be key rule making activities you have undertaken related to these two laws in the past two or three years?**

- **According to your testimony, the Board obtains the views of other federal regulatory agencies on Board rulemakings through "informal outreach" efforts and sometimes through comment letters. Do you believe that there should be a more formal process for vetting rulemakings of the Board?**

A.1. Regarding HMDA, the most recent revisions to Regulation C, which implements HMDA, took effect on January 1, 2004. The Board made significant changes to Regulation C, requiring lenders to report additional data to help capture significant, ongoing developments in the home mortgage market--notably the growth in subprime lending. The revisions brought greater transparency to the higher-priced segments of the mortgage market, where abuses are more likely to occur, by requiring loan pricing data to be reported and disclosed to the public. The expanded HMDA data offer significant benefits, such as promoting competition and encouraging lenders to strengthen compliance programs. The first data were released under the revised rules in 2005.

Regarding ECOA, the most recent revisions to Regulation B, which implements ECOA, took effect in April 2004, following a comprehensive review of the regulation. The Board made significant changes to Regulation B, requiring creditors to retain records for certain prescreened credit solicitations to address concerns about how national origin, race, age, or other prohibited bases of discrimination may be used in these solicitations. The Board also established an exception to the general prohibition against inquiring about applicants' personal characteristics for nonmortgage credit. The exception permits creditors to collect data about applicants' personal characteristics (such as national origin and race) for purposes of a privileged self-test.

Regarding agency outreach, I do not believe that there needs to be a more formal process for vetting rulemakings of the Board with other federal regulatory agencies. Board staff often consults with staff from the banking and thrift agencies and the Federal Trade Commission (FTC) prior to issuing an advance notice of proposed rulemaking. We use informal outreach to gather information from those agencies with particular expertise in a given area. For example, in reviewing the Regulation Z advertising rules, Board staff has

consulted with and will continue to consult with FTC staff because the FTC has particular expertise in the area of advertising law and regulation. And under the current process, other agencies can and do submit detailed comment letters in response to Board proposals.

Q.2. In your testimony, you cite the difficulty of full disclosure related to mortgage products such as Adjustable Rate Mortgages (ARMs) because of the unpredictability of interest rates. Please explain the Board's plans for examining the adequacy of mortgage disclosure laws, particularly as they relate to nontraditional mortgage products.

A.2. The Board is taking both immediate and longer-term steps to address concerns about the quality and balance of information consumers receive about non-traditional mortgages. The Board is conducting a comprehensive review of the disclosures required under the Truth in Lending Act (TILA), which is implemented by the Board's Regulation Z. The first stage of the review addressed disclosures for credit cards and other open-end (revolving) credit accounts, and the Board issued proposed rules for public comment in May 2007. The Board is now reviewing mortgage disclosures, and we will be considering changes to the content, format, and timing of the disclosures. To develop more useful disclosures, we will be conducting extensive consumer testing, as we did with the proposed new credit card disclosures. The testing is expected to begin in early 2008.

As an initial step in reviewing mortgage disclosures, last year the Board held a series of four public hearings on home-equity lending. At the hearings, we gathered views about whether the existing disclosures are adequate to inform consumers about nontraditional mortgages. In response to the hearing testimony, the Board revised the Consumer Handbook on Adjustable Rate Mortgages, which creditors are required to give to every consumer who receives an application for an ARM. The revised handbook gives consumers a better explanation of the features and risks of nontraditional ARMs, especially the potential for "payment shock" when rates adjust and the risk of increasing loan balances, known as negative amortization.

By the end of the year, the Board is planning to propose changes to TILA rules to address concerns about mortgage advertisements and solicitations that are incomplete or misleading. We also plan to propose amendments to require lenders to provide disclosures earlier in the shopping process so that consumers can get the information they need when it is most useful to them.

Q.3. What does the Fed intend to do in the area of nontraditional mortgage products? Do you believe the Fed has been proactive in this area, given the rise in foreclosures tied to subprime lending?

A.3. The Board has taken several actions in response to the concerns raised by nontraditional mortgage products and will continue to do so. Both past and future actions

taken in response to the proliferation of nontraditional mortgage products are outlined below:

- The Board, along with the other banking agencies, issued guidance in December 2005 to reduce the risks to banking institutions and consumers posed by nontraditional mortgage products. The mere act of proposing this guidance had a positive effect on the market, as many institutions took steps to conform their policies and practices to the guidance after its proposal. We finalized that guidance in September 2006. Moreover, we issued additional guidance this year, addressing hybrid ARMs in the subprime market.

- We have coordinated the development of our guidance with the states through the Conference of State Bank Supervisors (CSBS). The CSBS has indicated that it is committed to encouraging every state to adopt the nontraditional and subprime mortgage guidance, and to date more than half the states have done so.

- The Board also closely supervises state member banks and bank holding companies to make sure their policies and practices are consistent with the nontraditional mortgage guidance and the subprime mortgage guidance and, in general, to ensure safe and sound lending practices, including prudent underwriting. Specifically, the Board, along with other banking agencies and associations of state regulators, recently established an innovative pilot project to conduct targeted consumer-protection compliance reviews of selected non-depository lenders with significant subprime mortgage operations. The agencies will initiate appropriate corrective or enforcement action as warranted by the findings of the reviews or investigations.

The Board is also planning to use its authority under the Home Ownership and Equity Protection Act (HOEPA) to address specific mortgage lending practices that are unfair or deceptive. On June 14, 2007, the Board held a public hearing to discuss industry practices, including those pertaining to pre-payment penalties, the use of escrow accounts for taxes and insurance, "stated-income" or "low documentation" lending, and the evaluation of a borrower's ability to repay. We expect to propose additional rules under HOEPA before the end of this year.

Q.4. Given predictions of increased defaults and foreclosures with ARMs readjusting this year, what can the Fed do to stem the tide of the loss of homes?

A.4. The Board believes the rise in subprime delinquencies and foreclosures needs to be addressed in a way that minimizes abusive practices while preserving prudent lending standards and product innovation in order to maintain access to credit by non-prime borrowers. To that end, on June 29, 2007, the Board and the other federal banking agencies (the Agencies) issued the *Interagency Statement on Subprime Mortgage Lending* emphasizing the need for prudent underwriting and clear communications with consumers about adjustable rate mortgages targeted to subprime borrowers.

Although there are indications that the market is correcting itself, the Board remains concerned that over the next one to two years, existing subprime borrowers, especially those with more recently originated adjustable rate mortgages (ARMs), may face further difficulties. The Board and the other Agencies have encouraged financial institutions to identify and contact borrowers who, with counseling and financial assistance, may be able to avoid entering delinquency or foreclosure. In April 2007, the Agencies issued a statement encouraging financial institutions to work constructively with residential borrowers who are financially unable to make their contractual payment obligations on their home loans. Many lenders, sometimes in conjunction with community groups or state governments, have expressed a willingness to modify loan terms for borrowers at risk of foreclosure. Other lenders and market participants have formed programs to assist troubled borrowers.

Several Reserve Banks have spearheaded initiatives to respond to concerns about rising mortgage defaults and delinquencies, with the San Francisco Federal Reserve Bank holding forums in six cities to discuss community responses. Prudent workout arrangements that are consistent with safe and sound lending practices are generally in the long-term best interest of both the financial institution and the borrower and increase the potential for financially stressed residential borrowers to keep their homes. Further, existing supervisory guidance and applicable accounting standards do not require institutions to immediately foreclose on the collateral underlying a loan when the borrower exhibits repayment difficulties.

Committee on Financial Services Hearing on
Improving Federal Consumer Protection in Financial Services
Follow up Question from the Honorable Maxine Waters
to Office of Thrift Supervision
Senior Deputy Director Scott Polakoff
June 13, 2007

Question: You indicate that your regulatory authority is complete and adequate. That is a very bold statement in light of consumer protection issues before us. Why do you not need any additional regulatory authority at this time?

Answer: The Office of Thrift Supervision's (OTS) authority to issue consumer protection regulations comes from particular consumer protection statutes and the Home Owners' Loan Act (HOLA). Even in the absence of an express grant of rulemaking authority under a particular consumer protection statute, the HOLA still provides the OTS authority to promulgate regulations, including consumer protection regulations, applicable to savings associations as well as a variety of other entities within the savings association and savings and loan holding company structure. In particular, the OTS has the authority to regulate and examine savings associations, subsidiaries owned in whole or part by a savings association, service corporations owned in whole or in part by a savings association, savings and loan holding companies, subsidiaries of savings and loan holding companies other than a bank or subsidiary of a bank, and certain service providers.

The HOLA assigns the OTS Director a broad mandate to prescribe such regulations as the Director may determine to be necessary for carrying out the HOLA *and all other laws within OTS jurisdiction.* These other laws include more than thirty federal consumer protection statutes and regulations over which the OTS has jurisdiction to examine for compliance and to enforce.

In recognition of the OTS's consumer protection mission and the mandate that the OTS Director give primary consideration to the best practices of thrift institutions in the United States, the OTS has used its authority under the HOLA and other laws to issue rules that are unique among the federal banking agencies in the way they protect consumers.

One example is the OTS's long-standing Advertising Rule, which prohibits savings associations from using advertising or making any representation that is inaccurate or that in any way misrepresents a savings association's services, contracts, investments, or financial condition. The rule encompasses all forms of advertising, including print or broadcast media, displays or signs, stationery, and all other promotional materials.

Another example is special consumer protections for home loans made by federal savings associations. These encompass protections involving late charges, prepayment penalties, and adjustments to the interest rate, payment, balance or term to maturity. For example, a federal savings association may not assess a late charge on a home loan for any payment received within 15 days of the due date.

The OTS has also issued a Nondiscrimination Rule, which extends beyond the federal fair lending laws by prohibiting discrimination not covered by those laws. For example, the OTS's Nondiscrimination Rule covers all services offered by a savings association, not just lending. The OTS Nondiscrimination Rule also prohibits discrimination in lending on the basis of handicap and familial status regardless of whether or not the loan is residential real estate-related. The Equal Credit Opportunity Act does not prohibit discrimination on these bases and the Fair Housing Act, while it prohibits discrimination on these bases, only covers residential real estate-related transactions. The OTS rule also imposes a requirement designed to prevent lending discrimination by aiding in assessing fair lending compliance. Specifically, OTS requires savings associations and other lenders who file Home Mortgage Disclosure Act (HMDA) Loan Application Registers with the OTS to enter the reason for denials. This is information that is otherwise optional under HMDA.

The Federal Trade Commission Act (FTC Act) grants the OTS authority to promulgate rules to prevent unfair or deceptive acts or practices by savings associations in or affecting commerce, including acts or practices that are unfair or deceptive to consumers. This authority is similar to that provided to the Federal Reserve and National Credit Union Administration, with the statute granting the FTC other rulemaking authority.

A critical part of our existing authority to address consumer protection issues and potential abuses that may arise from programs of OTS-regulated thrifts and their affiliates is ensuring that our authority is clear and unambiguous; that the entities that we regulate understand the laws under which we expect them to operate; and that we consistently apply these standards to all segments of the industry that we regulate.

Consistent with our commitment to ensuring that our institutions understand what is expected of them with regard to compliance with federal consumer protection statutes and rules, the OTS recently issued an advanced notice of proposed rulemaking (ANPR) seeking comment on various issues involving unfair or deceptive acts and practices (UDAP). Our goal in pursuing the ANPR is to solicit public comment on whether the OTS should expand its current prohibitions against unfair and deceptive acts and practices and provide greater clarity regarding how we will make UDAP determinations going forward.

Pursuant to the ANPR, we are soliciting comment on whether to promulgate additional UDAP rules under the FTC Act and the HOLA; the effectiveness of existing OTS UDAP rules; and various approaches the OTS should consider in developing a UDAP rule, including approaches taken by the FTC, other federal agencies, and the States to define and prohibit unfair, deceptive, or otherwise abusive lending practices. The ANPR also solicits comment on the principles the OTS should consider in determining whether a *product* or practice is unfair or deceptive.

Finally, we recognize that the financial services industry and consumers benefit from consistent rules and guidance in the oversight of similar areas and activities. The federal banking agencies (FBAs) have adopted uniform or similar rules in many areas, and OTS is meeting and coordinating with the FBAs toward the goal of adoption of consistent interagency UDAP standards among the FBAs. During the current 90 day comment period (which expires on November 5, 2007) on the UDAP ANPR, we look forward to receiving public comments from Congress, consumer advocates, the financial services industry and other members of the public.

While OTS authority to administer and enforce applicable consumer protection laws is adequate, we would welcome legislative amendments in the following areas:

1. Repealing CRA Sunshine as part of regulatory burden reduction to enable OTS to further encourage cooperative efforts between financial institutions and community organizations.

2. Permitting the OTS Director to grant case-by-case exceptions to existing HOLA investment limits for various purposes, but subject to statutory qualified thrift lender (QTL) requirements, provided the institution has strong CRA performance.

3. Amending section 4 of the HOLA to add a provision clarifying that the OTS Director is authorized to issue consumer protection regulations he deems appropriate governing any entities the OTS has authority to regulate under the HOLA and correcting the title of subsection (a) to reflect that the Director's authority covers all savings associations, not just federal savings associations.

○