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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

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**Testimony on Improving Federal Consumer Protection in Financial Services
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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 rulemaking, 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.

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.

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;

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.

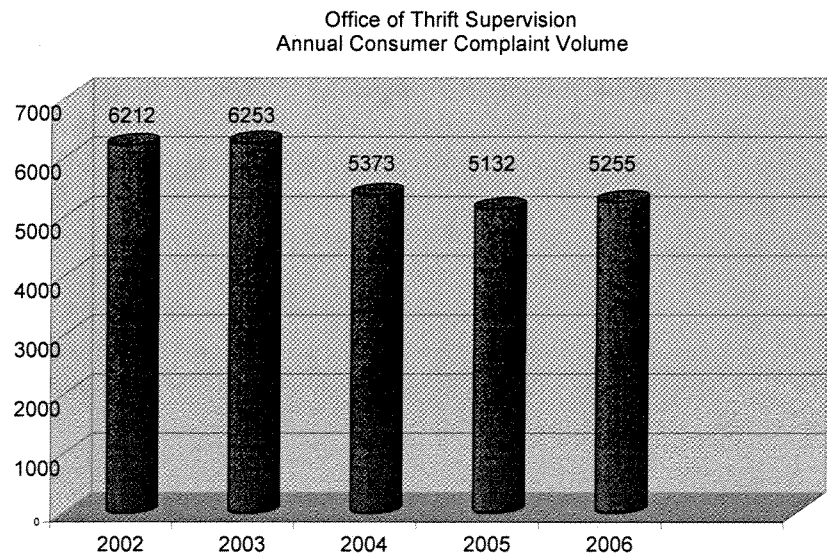
We also closely monitor industry credit card practices, particularly programs evidencing universal default characteristics and/or double-cycle billing. Another area of particular scrutiny with respect to credit card management practices is the application of minimum amortization standards by credit card 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.