Remarks by
John D. Hawke, Jr.
Comptroller of the Currency
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I've long believed that bank supervisors have a special responsibility where community banks are concerned -- not just because of your importance to your customers and the local economies you serve, but also because community banks tend to be especially susceptible to the burdens of supervisory policies and actions. That's why the Office of the Comptroller of the Currency takes so seriously the need to develop supervisory policies that are sensible, constructive, and supportive of community banks. ICBA is one of our principal sounding boards on issues of community bank supervision, and I'm delighted to be with you once again to discuss some important issues of mutual concern.

At the outset, let me repeat some points I have shared with you before. While OCC is sometimes thought of as the "large bank" regulator, the fact is that community banks make up an enormously important part of our jurisdiction. Of the 2100 banks we supervise, close to 2000, or 92 percent, are under $1 billion in assets. Almost 1000 of these – or 46 percent of all the banks we supervise – are under $100 million in size. 1300 of our examiners – about 80 percent of our total workforce – are community bank specialists, and most live in or near the communities whose banks they work with. Our Assistant Deputy Comptrollers, who make 90 percent of the supervisory decisions affecting their banks, average more than 20 years of supervisory experience. Each year this highly talented group of people conducts literally hundreds of outreach events for community banks around the country, and we in Washington regularly meet

with dozens of delegations of community bankers. In short, the OCC has a huge commitment to community banking. Beyond these institutional concerns, I personally believe that the nation's community banks are an essential foundation of our financial system, and I want to see community banks flourish and prosper.

Of course, my old friend Ken Guenther and the ICBA leadership have long provided community bankers with effective and forthright representation in Washington, and they are always there, looking over our shoulders, highlighting issues of particular importance to community banks, and reminding us of the importance of weighing the costs against the benefits of new regulations as we write them and implement them.

That the laws and regulations that govern banking are burdensome and costly is a proposition I suspect will get no argument from this audience. Scholars, industry groups, and government agencies have studied the question from almost every angle, and their studies invariably come to the same conclusion: regulation – particularly what we refer to as "compliance" regulation -- constitutes a significant and growing burden for banks of all sizes – a burden that falls with disproportionate weight on the smallest banks. Where large banks may have dozens of lawyers and other specialists working in their compliance shops – parsing regulations and advisories, drafting forms, following a myriad of court and agency rulings and interpretations, and dealing with examiners -- those tasks may be a part time responsibility for one person in many of your banks. Yet you have to understand and comply with the very same laws and rules as the largest banks.

The sharpest increase in regulatory burden has occurred in the area of consumer-oriented legislation. Since 1968, more than two dozen such laws have gone on the books, with the Truth-in-Lending Act (TILA) leading the way. Others followed in rapid succession: the Fair Credit

Reporting Act, the Equal Credit Opportunity Act, the Real Estate Settlement Procedures Act, the Community Reinvestment Act, the Home Owners Protection Act, the Home Mortgage Disclosure Act, the Consumer Leasing Act, the Electronic Fund Transfer Act, the Truth in Savings Act, the Fair Debt Collection Act, to name only a few -- and, most recently, the privacy provisions of the Gramm-Leach-Bliley Act.

The costs of complying with these laws, and the regulations promulgated to implement them, are substantial. In 1991, according to one study, those costs may have exceeded 12 percent of bank noninterest expenses. And this figure doesn't take into account the hundreds of millions of dollars that are spent annually by the supervisory agencies monitoring and measuring bank compliance with consumer regulations, or the hundreds of millions more spent examining for safety and soundness – costs that are directly or indirectly passed on to banks and taxpayers generally.

Statistical analyses lend credence to the point I made at the start: that compliance regulation is particularly onerous for community banks, which don't enjoy the economies of scale that are available to larger banks. A 1977 study, for example, showed that, for banks in the under-$10 million category, the cost of regulation per million dollars of assets was nearly twice what it was for banks with between $10 and $25 million in assets. Every subsequent study – and there have been many, of varying sophistication – has come to the same conclusion. But we didn't need teams of economists to tell us that.

What may be less immediately apparent is that the costs of bank regulation are spread over the broad economy. We have credible studies showing that regulation constitutes a significant barrier to the entry of new banking firms, that it reduces competition among financial

providers, and that it discourages innovation and creativity in the development of new financial services. All of this imposes burdens whose impact is felt well beyond the financial sector.

Yet it must be emphasized that bank regulation is an unavoidable necessity. Banking is not like other businesses. It was the first regulated business in America, and for a long time it was the only one. Banks are critical to the health of our economy, they operate our payments system, and they provide crucial financial services to the communities they serve. In recognition of their enormously important role, banks are the beneficiaries of a federal safety net and a system of deposit insurance. Avoidance of bank failure is a major objective of government policy. The rationale for bank regulation was unarguable 200 years ago, and it's unarguable today.

Of course, the vast majority of compliance laws are of more recent vintage. It's important to remember, however, that these laws – and the burdens they've created – were not enacted in a vacuum. Almost without exception they were responsive to abuses in the financial marketplace that the banking industry had proved unable or unwilling to correct on its own. In many cases, these abuses were engaged in by a relatively small number of banks, but they were abuses nevertheless. It is a simple fact of political life that legislators will respond to the conduct of the worst actors, and will generally do so with laws that affect the business of all, including the best.

One need only recall – to cite just a few examples -- the impossible welter of incompatible approaches to interest rate calculation that had been used by financial institutions, or the frustration that customers sometimes faced in getting billing errors corrected, or the discrimination on grounds of race or gender that some borrowers faced, or the abusive practices used by some unscrupulous collection agents, or the epidemic of "redlining" that contributed to the decline of so many inner city neighborhoods, to understand why legislators found appeal in

these laws. No doubt, TILA and CRA impose burdens on financial institutions, but it cannot be denied that they were responsive to real abuses.

To be sure, much good has come from these compliance laws. There is little doubt, for example, that the financial marketplace is fairer and more rational than it was a generation ago, especially for women and minorities and other previously neglected groups. Since the advent of standardized APR disclosures, consumers have been able to understand the true cost of credit and to do the kind of comparison-shopping that was always difficult before Truth in Lending and Truth in Savings went into effect. Shopping for a credit card became simpler when consumers could turn to the so-called Schumer Box on the issuer's solicitation for information on interest rates, grace periods, and the like. And while obtaining a mortgage loan and seeing it through to closing can still be something of an ordeal, there's far greater transparency about the process -- and the costs associated with it -- since TILA, RESPA and their cohorts became the law of the land.

Certainly we've come a long way since the wild and wooly days when caveat emptor was the only real protection available to the financial consumer. Yet there's also plenty of evidence that we could be doing better – and getting a better return on the large investment in time and money that goes toward maintaining a fair and open marketplace for financial services through compliance regulation.

Many people take it for granted – indeed, take it as an article of faith – that simply because a particular set of disclosures is required by law, it must be valuable and important. It's significant that most of the evidence we have to the contrary is anecdotal. Many of us who don't read the pages of disclosures that accompany loan or new account applications or credit card statements assume that others aren't reading them either. We know about the frustration of trying

to wade through paragraph upon dense paragraph of legalese. We hear stories – stories that seem quite plausible -- about settlement agents impatiently suggesting that a real estate closing might have to be rescheduled for a later date if the borrower insisted on reading all the disclosures. Legend has it that a large national bank conducted its own non-scientific survey by inserting a line of fine print somewhere in the middle of a lengthy disclosure document offering $100 to any customer that brought the item into a branch – and that not a single customer did.

The question of efficacy in our system of financial disclosures has a more troubling dimension as well. Despite the prevalence of disclosure as a cure for abuse, there is still much of what many people would see as shortsighted decision-making by financial consumers. Those who believe that many consumers don't always act in their own self-interest watch people paying payday lenders fully disclosed APRs that may reach 500 percent or more, and they conclude that mere disclosure is not enough, and that more stringent substantive regulation is needed.

Of course, one needs to be careful here. After all, a free society gives people the freedom to make bad choices as well as wise ones. There is sometimes a troubling tendency to believe that just because someone is not wealthy, he or she may not be smart enough to be trusted to act in their own best interest.

I happen to believe, on the contrary, that people with limited means are more likely to make choices that are economically sensible for them. To be sure, people with limited means may not have the same access to financial products as more prosperous customers, and they may in some cases present greater risks that translate into higher costs. Assuring fair and nondiscriminatory access to credit and other financial services is of course a critically important objective of government policy.

Nonetheless, there is an important question whether our consumer protection and disclosure laws effectively provide individuals with the information they need to make informed personal choices. I believe that they often don't. Unreadable, unfathomable, and costly disclosures may be no better – and they're possibly worse -- than no disclosures at all. Unfortunately many of the disclosures that fill our mailboxes and settlement packages fall into the "unreadable and unfathomable" category. Yet the costs to financial institutions to provide these disclosures may nonetheless be enormous.

The truth is, it would be remarkable if our consumer disclosures <u>were</u> effective, considering how little attention we've paid to <u>making</u> them effective. In contrast to the multitude of industry and academic studies that have appeared over the years on the <u>cost</u> of our regulations and disclosures, very little has been done to assess their <u>efficacy,</u> let alone to weigh the benefits against the cost burdens of compliance.

I'm aware of just a handful of exceptions to this general rule. In the mid-1970s, when Ken Guenther and I were very young colleagues at the Federal Reserve, a study was performed that focused on "information overload" – the concern that TILA disclosures were so extensive that they actually interfered with the ability of consumers to get the information they really needed. These concerns gave rise to the Truth in Lending Simplification Act of 1980. Significantly, the Simplification Act took up more pages in the statute books than Congress needed when it enacted TILA in the first place. Suffice it to say, this well-intentioned effort did not result in a more effective, less costly disclosure regime.

In 1996, the Federal Reserve and the U.S. Department of Housing and Urban Development (HUD) were directed by Congress to prepare recommendations for reform of TILA

and RESPA disclosures. A year later, the two agencies submitted their report – a report that, with appendices, ran well over 100 pages.

The study found many technical problems with the existing disclosure regime, and it issued more than a dozen specific recommendations for improvement. It noted that consumers in mortgage loan transactions are often required to pay various fees to their lender before the lender is required to provide the required disclosures, giving the borrower an incentive to go through with the transaction regardless. The agencies pointed out that RESPA "good faith estimates" often turn out to be incomplete and inaccurate – almost invariably to the disadvantage of the borrower. And they recommended an expansion in the definition of the finance charge to assure that all costs the consumer is required to pay to close the loan were reflected in the APR.

Some of these recommendations await action by Congress; others have already been adopted under the two agencies' rulemaking authority.

Yet only in passing did this comprehensive study even touch upon what may be a more fundamental flaw in the existing TILA/RESPA disclosures -- their sheer oppressive weight, their inscrutability, the confusion or cynicism they engender among the consumers to whom they are given. Nor did the study come to grips with a critical basic question – a question that could be raised about almost all compliance regulation. Are the benefits being delivered to consumers worth the costs being imposed on the industry? Or, to put it in more positive terms, can we improve the effectiveness and value of these laws and at the same time relieve financial institutions of some of the deadweight costs of compliance?

These are critically important questions, because the costs of compliance are not a free good. It must be assumed that most, if not all of these costs are passed on to consumers. They

become, in effect, part of the cost of credit and other financial products and services – costs that the intended beneficiaries must themselves bear.

I believe that legislators and policymakers need the answers to these questions, and the inquiry should not be approached on an ideological basis. It should be very pragmatic. Are we getting our money's worth? More specifically,

- Do the laws in question maximize the ability of consumers to understand the relative costs, benefits, and limitations of financial transactions by providing key information in a clear, easily understandable way?
- Do they maximize the ability of consumers to make informed and appropriate decisions based on the information they've received?
- What in fact are the costs of compliance? What magnitude of resources are devoted to compliance by banks, and what are the costs incurred by supervisors in implementing and overseeing compliance?

To answer these questions, I believe we need an independent, professional, well-funded research effort that would not only survey and document the costs of compliance regulation, both for banks and for regulators, but would analyze whether consumers are getting the most user-friendly and effective protections we can offer. I am convinced we can do better in serving the interests of consumers, and do it more simply and at less of a cost burden.

I know there's a better way, because we've seen it in action.

The U.S. Food and Drug Administration (FDA) had a voluntary nutritional labeling program for packaged foods as early as the 1970s. But in the face of evidence that this framework wasn't meeting the growing public interest in the nutritional content of packaged foods – or rising health concerns about the American diet -- the FDA decided to switch to a new

arrangement. It's significant that the FDA decision to adopt a mandatory system of uniform labeling predated the passage of federal legislation; for the most part, the Nutritional Labeling and Education Act of 1990 called for changes that the FDA had already initiated under its rulemaking authority.

Four years later, the now familiar "nutrition facts" panels began to appear on food packages throughout the country. Finally consumers had -- in simple, readable form -- the right kind of reliable, relevant, and consistent information about what they were buying and consuming. And they had it at a critical time – before they made a purchase. If they choose to make unwise dietary decisions nonetheless – and certainly the new information has proved to be no panacea from a public health standpoint – it's not because the information they need to make sound decisions at the supermarket isn't available to them.

Four years from conception to rollout may seem like a long time. But this was time well spent. The FDA took pains to bring all interested parties – industry, public health experts, consumer groups, and regulators -- into the process. Consumers were intimately involved from the start. Extensive task-based testing was performed to establish what consumers were looking for and how they intended to use the information; different disclosure formats were developed, refined, and tested, focusing on ease of use and accuracy. Consumers were then surveyed on their views of the label design. Was it legible? Easy to use? Did consumers understand what was being presented? And did it serve its intended purpose?

Enough said "yes" to give us the "nutrition facts" format we have today. The acceptance and the accolades it's won – including the coveted Presidential Design Achievement Award -- speak for themselves.

I believe that every regulator in America can learn from the FDA experience. It should certainly encourage us to reconsider the way we've gone about developing our disclosure regime for financial institutions. We have to start by talking to the people for whom the disclosures are designed to learn more about their needs and how those needs are best met. We have to do more research, more testing, more consulting with end users, and more validating to ensure that our disclosures produce positive results and not simply more waste and frustration.

Fortunately, we may have an opportunity at hand for a new beginning in the design and implementation of financial disclosures to consumers.

As you well know, Title V of the Gramm–Leach–Bliley Act (GLBA) created privacy standards that financial institutions must meet to protect their customers' personal information – and, at the same time, required financial institutions to inform consumers about how those standards were being met. These requirements have led to disclosures that, at their worst, embody all that's wrong with our current approach. Today's privacy disclosures are long, dense, complex – and, if the anecdotal evidence is to be believed, likely to wind up in the trash without having been read. While a major objective of the new law was to give consumers the ability to "opt out" with regard to the sharing of their personal information with third parties, it takes enormous fortitude – and, seemingly, a graduate-level education – to unravel the language that instructs consumers on how to accomplish this.

We can't place the blame on financial institutions for the unwieldiness of our privacy disclosures. After all, Congress left them with little discretion in determining what belongs in privacy disclosures – and left the regulators with very little time to develop appropriate standards. The FDA took four years. In our case, seven financial regulatory agencies were expected to compose their differences and produce privacy standards in six months.

Congress was quite explicit in requiring that the disclosures include discussion of the kinds of information that the financial institution collects, the categories of persons to whom the information is or may be disclosed, and the policies and practices of the institution with respect to disclosing the nonpublic personal information of those who are no longer customers of the institution. Additionally, the disclosure must explain the policies that the institution has to protect the confidentiality and security of the nonpublic personal information.

I defy anyone to convert that mass of information into a form that would fit on the side of a cereal box.

But there may be a better approach – a "layered" approach under which consumers would receive a "short-form" privacy disclosure with a few basic facts presented in large, boldface type. This disclosure would provide only the basic information – such as the fact that the institution shares the consumer's information with third parties for marketing purposes, and that the consumer has the right to block such sharing arrangements. But it would also advise consumers about where to turn – with a phone number or a website address, for example -- to obtain a more detailed disclosure with all of the information required by GLBA.

We believe that this approach would meet both the letter and the spirit of the law. For surely it was not the intent of Congress in enacting privacy legislation to leave consumers more baffled and frustrated than before. Nor were the GLBA privacy provisions intended to embroil financial institutions in a costly paper exercise that adds burden without benefit.

As I said, this is only a concept – and only a start. Clearly, there is much work to be done in moving toward the more consumer-centric approach to disclosure pioneered by FDA. We still know too little about the kinds of financial information that consumers need and want. The basic

research in this area remains to be done. But I believe that our concept could take us an important step toward a more efficacious regime of financial disclosure.

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Financial institutions tend to see consumer regulation as an unavoidable fact of life – as a burden to be endured. Yet it can be much more than that, as the food industry's experience with the FDA proves. Food manufacturers entered the new disclosure era not quite kicking and screaming, but with a healthy skepticism. They soon discovered, however, that better nutritional labeling could work to their competitive advantage. By learning what consumers wanted – products with less fat or cholesterol, for example – they were able to reformulate existing products and develop new products that met the evolving demands of the marketplace.

The message for bankers should be clear: figure out what consumers want and give it to them. That basic rule of commerce applies to financial services as much as it does to the food industry. Compete on the basis of openness. If banks provide clearer and more relevant information – and brag about it -- they'll be better able to tailor financial products that meet consumer tastes and preferences, build customer loyalty, and draw new customers into the fold.

In that sense, we should start viewing disclosure not as a burden, but as a competitive opportunity. It's a view I would encourage all bankers to embrace.