Remarks by
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It is a pleasure to be here with all of you this afternoon. I continue to admire and to be deeply impressed with the fine work the Banking Institute provides to the banking and legal communities, and I am honored to have the opportunity to be with you again.

Today, I want to talk about a topic we can relate to professionally, as financial services practitioners, and personally, as consumers – the role disclosure plays in financial services regulation.

Today, consumers might well feel like they are drowning in information. For financial products and services in particular, consumers get drenched in details about new offerings and specialized products, and they may reach the point of feeling deluged, as they face more and more details about product and service choices offered by an evolving and innovative financial services industry. But what is all this accomplishing?

Let me start by quizzing this audience of financial services experts with some consumer-oriented questions --

How many of you understand all the disclosures you receive from your financial services providers?

How many of you actually *read* all those disclosures?

How many of you throw the disclosure statements in the trash after one quick glance, if that?

I suspect that, despite our professional training, we all share some common consumer reactions when it comes to many of the consumer disclosures in use today. And even making the generous assumption that your responses are typical of the "average" consumer, we all should be concerned about the lack of an enthusiastic reaction to the disclosures currently being provided in connection with financial products and services today.

Let's pause for a moment and compare this reaction to how you feel about the disclosures you get in connection with your choices of ***food.***

How many of you check the "Nutrition Facts" label when you buy a bag of potato chips? Soda? Candy? Cereal?

Can you easily tell the calorie, carb, sodium, or fat consequences of your choice?

Do you ever compare the calories, or fat levels between different products when you make a selection?

Do you sometimes make an indulgent choice, but vow to work it off the next week?

The "Nutrition Facts" box that gives you the information to make these choices may be the most prevalent and frequently used consumer disclosure in the marketplace today. And these disclosures have not only enabled consumers to find products with the nutritional characteristics they're seeking, the clear labeling of nutritional content has influenced food producers to develop products that consumers *want.* In other words, these disclosures have been effective and *useful* to consumers. Why is this? More importantly, what can we do to emulate the generally positive response we have to food product disclosures in the context of financial product and services disclosures?

Shouldn't we all be concerned if I'm getting more meaningful, comprehensible disclosure when I buy a bag of potato chips than when I commit my current and future financial resources, my hopes and my dreams, taking out a mortgage to buy a home?

With the increasing significance of consumer business to the banking industry today, and with disclosures at the foundation of our consumer protection regime, it is vital that disclosures ***work*** to effectively inform consumers of what they need and want to know.

The significance of the consumer business to banks today also accentuates how consumer protection and safety and soundness considerations converge. How a bank treats consumers through its disclosure and marketing practices not only reflects on the integrity of the bank's operations, it is also inextricably connected with evaluation of the safety and soundness of its banking business. How could we say that a bank is operating safely and soundly, regardless of how profitable it may be, if its revenues and capital were the product of deception, or discrimination, or other activities that are illegal or illicit?

A good example of this convergence of traditional safety and soundness standards and consumer protection concerns are the issues intertwined in the current debate regarding so-called "non-traditional" mortgage products. The proposed supervisory guidance on these products issued by the Federal banking agencies late last year reflects this convergence, addressing traditional areas of safety and soundness – prudent loan underwriting practices and appropriate portfolio and risk management techniques – but also extensively discussing consumer protection concerns that may be raised by these products, particularly disclosures and disclosure practices that effect whether borrowers are fully apprised of, or are likely to understand, the products' terms. The proposed guidance not only describes the agencies' expectations concerning sound practices in *each* of these three areas, it also equates sound management of the risks associated with non-traditional mortgage products with effectively addressing *all three areas*.

Many of you may be familiar with these nontraditional mortgage products, such as "interest-only" loans, or "payment option" adjustable-rate mortgages. Interest-only mortgages allow borrowers to defer the payment of loan principal for a certain period and only pay the *interest* due on the loan, either at fluctuating or fixed rate. Later, the borrower must make principal and interest payments at an accelerated pace, and potentially with a much higher interest rate.

So-called "payment option ARMs" offer not only an interest-only option, but also a "minimum payment" option that does not cover all of the interest due – in other words, where the mortgage negatively amortizes. The unpaid interest is added to the principal, which today is usually capped at 115 to 125 percent of the original loan amount. While often innovative and liberating for certain consumers, these types of products also carry novel risks.

And we have seen some institutions combining these products with other higher-risk practices, such as simultaneous second-lien mortgages, and the use of reduced documentation in the evaluation of an applicant's creditworthiness, such as requiring less stringent or even no income and asset verification. Use of these risk-layering practices, in combination with the broader marketing of nontraditional mortgage loans, exposes financial institutions to increased risk relative to traditional mortgage loans.

The content of the proposed guidance reflects the intersection of safety and soundness and consumer protection implications of these products. The guidance cautions that institutions should ensure that loan terms and underwriting standards are consistent with prudent lending practices and that institutions should adopt robust risk management practices to manage these loan exposures. But, coupled with these expectations is the concern that disclosures and marketing practices ensure that consumers have the information needed to clearly understand the loan terms and associated risks prior to making their product choice. That is not to say that a *consumer's* understanding of a product is part of a *bank's* underwriting process. But it certainly does affect the larger dimension of risk that the bank assumes when it makes a non-traditional mortgage.

Interest-only and payment-option ARMS can be complicated products. Do consumers receive good disclosure about how the products work and how their payment obligations could increase?

Do they understand how interest rate risk is being shifted to them?

Are marketing practices employed that help, or hinder, consumers' ability to understand the obligations they are taking on?

In addressing the myriad of risks raised by these products, the agencies' proposed guidance sets forth in considerable detail numerous recommended practices. I will forego many of the details, but touch on four prominent areas flagged in the guidance: (1) communications with consumers; (2) promotional materials and descriptions; (3) monthly statements to consumers; and (4) obscuring information or unwarranted practices.

In communicating with consumers, the proposed guidance emphasizes that institutions should present important information in a clear manner and format such that consumers will notice it, can understand it to be material, and will be able to use it in the decision-making process to make informed decisions and use products responsibly. For example, institutions should offer full and fair product descriptions when a consumer is *shopping* for a mortgage, not just upon the submission of an application or at consummation. Likewise, the proposed guidance recommends using promotional materials and descriptions that include enough details to enable consumers to prudently consider the features and risks of these mortgages, and that specifically provide information about payment shock, negative amortization, prepayment penalties, and other risks that may not be fully understood by consumers.

Another area of focus in the guidance is the information provided consumers in monthly statements. The proposed guidance recommends, for example, describing in the statement the consequences of selecting various payment options as they effect the current principal balance. It also highlights various practices that institutions should avoid because they obscure significant risks to the consumer or mischaracterize possible outcomes. For example, where an institution advertises or promotes a non-traditional mortgage by emphasizing the comparatively "low" initial payments – something we've probably all heard – the institution also should provide clear and comparably prominent information alerting the consumer, appropriately, that these payment amounts will increase, that a balloon payment may be due, or that other significant implications for the loan balance may occur prospectively.

What the proposed guidance illustrates, and what is becoming fundamentally more important to grasp, is the linkage between the prudent underwriting practices and risk management standards – in other words traditional safety and soundness considerations – and the consumer's opportunity to appreciate the risk he or she is assuming with a particular financial product. Effective disclosures that enable consumers to understand the risk of a product effects the larger dimension of risk that the bank assumes when it makes a non-traditional mortgage. It's not just the additional safeguard of a particular consumer's self-assessment of his or her ability to repay a loan. It's also about whether the bank has a good answer if it becomes embroiled in allegations by multiple borrowers that the true terms of the loan were not fairly presented to them.

But that brings us to the crux of the current dilemma. What good is disclosure of a lot of information if it's not ***effective*** disclosure? As we observed earlier, we all seem to know what are <u>not</u> effective disclosures: notices with too much information, too many legal terms, and too much variability in presentation. What is important for consumers to know about a particular product or service?

While it is easy to say disclosures should be clear, timely, and meaningful, getting to that point is more difficult than at first it may seem. The deficiencies in the current approach are obvious. We all should share a common interest in our roles as consumers, lawyers, bankers, and regulators in solving this challenge. Doing so, I think, requires is to rethink how we implement consumer-oriented disclosures in the financial services business.

I don’t mean to suggest that we should discard the basic approach of reliance on disclosures and consumer choice to accomplish important consumer protection objectives. One of the great strengths of our financial system is that the government does *not* dictate the price and terms of products and services that may be offered. But, in order for this free market to work, consumers need to have the means to make *informed* decisions.

An initiative currently underway by the federal banking agencies and the Federal Trade Commission may be the icebreaker that is needed. As you may know, the banking agencies and the FTC are engaging in a major effort to simplify consumer financial privacy notices. In 2003, the agencies published an Advance Notice of Proposed Rulemaking outlining and seeking comment on a new approach to privacy notices – one that would make these notices shorter and easier for consumers to understand and use. The rulemaking sought comment on several sample versions of streamlined, short-form notices, with key information presented in a simplified check-the-box or yes/no format, and more detailed information available in a “layered” approach, either in another accompanying document, or upon request. Most significantly, the agencies pledged to engage in consumer testing before proposing changes to the privacy regulations.

The agencies then retained expert consultants to test privacy notices with consumers. The object of the testing is to assess weaknesses with current notices, suggest alternatives that correct these weaknesses, and test these alternatives with consumers. And the purpose of this latter testing, obviously, is to determine whether consumers find the notices useful – not just whether they like the way they look.

For example, if a consumer wants to limit his bank’s sharing of personal information, can he easily determine from the notice how to “opt out”?

If a consumer wants to compare sharing practices among banks, can she easily do so based on the banks’ notices? In other words, does the consumer have the means to make an *informed* decision by using the notice.

One thing I have learned in focusing more intently on this area over the past few years – lawyers and technicians – however well-intentioned – should never be put in charge of drafting consumer disclosures. Take the revisions to the privacy notices, for example. In 2003, attorneys at the banking agencies – *and I was one of them* – drafted the model privacy disclosure forms included in the advance notice of proposed rulemaking. I honestly believed ours was a marvelous attempt and significant improvement over the original privacy notices. Well, I’m now here to tell you that we didn’t come close to understanding, much less utilizing, all the techniques that experts use to design consumer disclosures that are really effective for the audience we want to reach.

As I am speaking to you here, practically simultaneously, the interagency privacy notices working group and the consultants the agencies retained are conducting a briefing in Washington, D.C. for interested stakeholders, to describe the testing process and announce their findings. Tomorrow morning, the federal regulators will officially release the consultant’s report. The OCC’s website will contain an electronic link to access the report.

As you will learn in more detail, the testing that was undertaken involved focus groups and in-depth one-on-one interviews with consumers throughout the United States. The consultants used the results of successive rounds of interviews to continually refine sample privacy notices to make them easier for consumers to read and understand. The testing resulted in the development of a model simplified notice.

We learned some lessons during this first phase of testing, including the importance of keeping the notices simple. Consumers are overwhelmed by complex information. We also learned that simple language isn't enough. Good design makes the notices easier for consumers to read and focuses their attention on important information. We also found that consumers need a context for understanding information in financial privacy notices. Providing some background information about financial privacy laws and information sharing practices – in other words, answering the unspoken question – "why am I getting this notice" – allows consumers to better understand the specific practices of their own institutions and when they have choices about how their own data is handled.

Let me also underscore the significance of this project. This is the first time the Federal financial services regulators have worked together to sponsor this type of consumer research to improve consumer disclosures. Perhaps most extraordinarily, the regulators initiated these actions – Congress did not mandate consumer testing, and no one asked the regulators to conduct this testing. This is just an example of good government – using government resources to establish that a consumer disclosure actually *works* before mandating its use by the private sector.

Even though phase one of the testing is complete, the project continues. The agencies will publicly announce during the briefing today and in a press release tomorrow, their intention to conduct further testing to evaluate the results of this initial testing project. The second phase of testing will encompass a larger pool of consumers and seek to evaluate the usefulness and effectiveness of the simplified notice that resulted from phase one of testing, as well as other privacy notices.

Ultimately, we will use the results of the first and second phases of testing to guide the agencies' next steps in advancing the use of simplified notices. To be clear, we are deferring any decisions about next steps until the testing is complete. If we choose to propose changes to the privacy rules after the testing phases are complete, it will be via a rulemaking proposal, which will invite broad public comment.

So where does that leave us today? It is hard to dispute that, in order to achieve understandable and effective consumer disclosures, one critical element we need to embrace is consumer testing when we design, or attempt to redesign, consumer disclosures. The Food and Drug Administration took several years in their efforts to develop the "Nutrition Facts" box that I mentioned earlier. The nutrition label was the result of painstaking laboratory and fieldwork, notably including extensive input by consumers.

We need to learn from that example. We need to be patient, and we need to be willing to invest both the time and the resources required to conduct the type of testing essential to design of effective disclosure materials.

Producing effective consumer disclosures requires more than good intentions and technical expertise in applicable legal requirements. Indeed, the scope and variety of information currently required to be disclosed to consumers – that downpour of information that they find *hard to understand and use* – is probably traceable to good intentions by lawyers, advocates and legislators. What's missing is enhanced *consumer* input as part of the regulatory process via the techniques and expertise of market researchers, which help focus requirements on the information that is actually useful and effective for consumers' decisions.

I am not saying this change in approach to consumer disclosures in the financial services industry will be easy. It will take time – more time than some recent rulemaking directives have allowed – and we need to take the ice-breaking step of utilizing the expertise and results of consumer testing as part of the process of setting disclosure requirements.

But, the long-term benefits can be profound: better-informed and better-protected consumers, clearer accountability concerning consumer treatment and consumer behavior; reduced regulatory burden; and a stronger financial services marketplace for all. It is a challenging and exciting prospect.

Thank you.