

Remarks by  
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It's not news to anyone in this room that the banking industry is under attack – once again. State and local legislatures around the country have enacted, or are considering, new laws to regulate various aspects of the business, state law enforcement officials are making dramatic headlines announcing large-dollar settlements, federal regulators are issuing regulations and guidance, consumer activists are leveling broadside barrages, and committees of the Congress are holding hearings and conducting investigations aimed at determining whether new federal laws are needed to curb abusive practices.

So “what’s new?” some of you might ask. Banks have always been a favorite target. It’s really just a measure of how important the industry is. And, after all, you’ve learned to live with the burdens of regulation.

Others have a different view. They shake their heads in dismay at the two dozen or more compliance laws passed in the last 30 years – laws that have imposed tremendous burdens on the industry. How many times have you heard a banker friend say that the business “is just not fun any more”? How many times have you cringed just a little bit, or felt you had to apologize, when someone has asked you what your profession is? Believe me: having been a lawyer for over 43 years, I know the feeling.

What's gone wrong? Bankers have traditionally been leading members of the community, and the banking business – a business that, after all, was built on the trust and confidence of customers – was once considered a model of good conduct and rectitude. When I was a new young lawyer the practice of “banking law” largely meant drafting loan agreements and forms. Today, “bank regulatory law” is a major practice area, with law firms competing actively to hire lawyers who know how to guide clients through the shoals of regulations intended to protect consumers by constraining banker misconduct. What has brought this about? Why have banks become everyone's favorite whipping boy? More to the point, what can we do about it?

As one looks back over this period during which the burdens of regulation have become so heavy, there are two circumstances that emerge as common to almost all of the legislative and enforcement activity we have seen: First, they are virtually always responsive to real abuses. Congress generally does not sit around dreaming up ideas for new laws to address hypothetical or speculative problems. On the contrary, it is generally quite unusual for Congress to move quickly on regulatory legislation – the Gramm-Leach-Bliley privacy provisions being a major exception. Most often they respond only when there is evidence of some persistent abuse in the marketplace over a long period of time.

The second common element is that the abuses that cause legislation are almost always the actions of a very few players, and not pervasive practices in the industry. History could not be more clear: a few bad actors will generally be the cause of burdensome laws that are brought to bear on the activities of the entire industry.

So when we ask what can be done about it, a very natural follow-up question is why has the industry itself failed so profoundly to address the conditions that have given rise to so much regulation? Can't it do better?

Nearly twenty-five years ago, I wrote an article entitled, "Deregulation and Self-Regulation: Illusion or Reality." It was a time of real pessimism about prospects for thoroughgoing bank deregulation, a pessimism that I generally shared. But if there was hope for a new day in banking, I wrote, it seemed to me to hinge on the industry itself doing a better job of addressing its own shortcomings. It also seemed evident to me that the industry's failure to address demonstrated abuses had been responsible for the succession of tough consumer protection laws of the previous decade, such as the Truth-in-Lending and Equal Credit Opportunity acts. But it wasn't too late, I argued, for the industry to take a historic new path toward self-regulation, with all the benefits such a reversal could bring. While I thought it was unrealistic to expect that self-regulation would persuade Congress to repeal existing regulatory laws, I suggested that a good-faith effort by the industry might demonstrate that future regulatory legislation was unnecessary.

There is no question that we have made progress in dismantling some of the more archaic remnants of an earlier regulatory era. Deposit interest rate controls were largely discarded over two decades ago, and we are on the verge of having the prohibition against paying interest on demand deposits phased out. But it often seems that for every step or two we take toward regulatory emancipation, we take at least one step back. Banking today continues to operate under multiple layers of regulation that, while

undoubtedly providing some protections to consumers, can be extremely burdensome and costly – indeed suffocating – to small banks.

When I addressed the ABA convention last year, I spoke to you about the dramatic changes that were taking place in the country's legal framework for corporate governance. The centerpiece of that change was the Sarbanes-Oxley Act – perhaps the most important piece of corporate reform legislation in our lifetimes. It is significant in the present context, however, that this landmark legislation responded to a relatively small number of highly publicized cases of corporate abuse, virtually none of which directly implicated financial institutions. Indeed, some of its provisions pertaining to the relationship between corporations and their directors duplicated safeguards already in place for financial institutions.

That's not to say that the banking industry hasn't benefited tremendously – and won't continue to benefit well into the future -- from the general improvement in public confidence wrought by Sarbanes-Oxley – improvements resulting from greater transparency in corporate balance sheets, more honest and accurate accounting, compensation reforms, and the rest. But along with those benefits come burdens, and the burdens have fallen just as heavily on an industry like banking.

But if banks were only incidentally in the zone of corporate reform legislation, the banking industry has been at the center of other key public policy issues – issues such as financial privacy and identity theft, predatory lending, and credit card account management practices. Together they represent a challenge that may profoundly shape the industry's future. The industry's response to that challenge could go far in determining whether there will be new regulatory mandates in each of those areas, as

well as how costly and burdensome those mandates will be. And that in turn will have a role in shaping the industry's ability to meet the competition of the financial marketplace and to continue on in service to our nation's economy.

Let's take a look at the issues of privacy and identity theft. The industry's commitment to safeguarding customer confidentiality has long been an article of faith. A 1961 court case declared that:

“It is inconceivable that a bank would at any time consider itself at liberty to disclose the intimate details of its depositors' accounts. Inviolable secrecy is one of the inherent and fundamental precepts of the relationship of the bank and its customers or depositors.”

But what was inconceivable in 1961 was hardly unthinkable a few decades later. And those privacy precepts, once inherent and fundamental, came under increasing pressure from technology – which made customer information increasingly available for sale and analysis -- and from the competition to diversify, which made consumer information an increasingly precious commodity to an industry that has always been information-based.

Amid growing consumers concerns about threats to their privacy, most financial institutions recognized the danger to their longstanding reputation for preserving customers' trust. But a few cases of slippage began coming to light. It was headline-making news when one institution was reported to have sold confidential account information to a telemarketer. That revelation led to thousands of depositor complaints, a multi-million dollar cash settlement, and huge embarrassment. The industry was conflicted. Some recognized the need to develop effective privacy standards, but others

put a higher value on the need to use customer information to exploit cross-marketing opportunities. Congressional hearings produced stories of the ease with which pretext callers were able to glean account information from careless bank customer service representatives. Many in the industry seemed to believe that privacy was an issue in which consumers would soon lose interest.

But privacy has lost none of its importance to consumers since Gramm-Leach-Bliley was signed into law – quite the opposite. According to Department of Justice statistics, seven million Americans were victims of identity theft last year, making it the nation’s fastest-growing financial crime. Some 30 million Americans have already registered with the Federal Trade Commission’s National Do Not Call Registry – and I doubt that many of them have a warmer place in their hearts for telemarketing calls that come from banks than from third-parties. And of course, GLBA enabled states to enact tougher privacy standards in some respects, with California poised to do just that.

Although I see some evidence that bankers are beginning to recognize that privacy is and will remain a key competitive factor – that consumers will bank where they feel that their privacy is particularly well protected and stop banking where it’s not – progress toward self-regulation and standard-setting in the privacy area since GLBA has not been what one would have hoped for.

Let me give one recent example. The federal banking agencies recently came out with proposed guidance for banks setting out procedures they should follow when they have evidence that confidential customer information has been compromised. This is a tough problem. Should a bank notify its customers in every case where there has been a compromise – perhaps causing undue and unnecessary alarm and concern among

customers? Or should it wait to see if the confidential information has been misused – in which case it might be too late to avoid irreparable injury to the customer?

Here was a clear opportunity for leaders in the industry to recognize the need for an industry standard or best practice, and to take the lead in addressing this need. To be sure, even responses generated by the industry itself won't always stave off a governmental response, but it's certainly worth the effort. Let me put it in a different way. Would you rather have strong and responsible guidance from your own industry in dealing with an issue of this sort, or a governmental dictate enforceable through bank examiners and cease-and-desist orders? In the absence of the former, you are now faced with the latter.

Let's turn to the case of predatory lending – another of today's most pressing financial public policy concerns. I define predatory lending to mean the aggressive “pushing out” of credit to borrowers who cannot pass the conventional standard of bank underwriting: does the borrower have the capacity to service and repay the loan without recourse to the collateral?

State after state, and city after city, are adopting or considering laws that would subject all mortgage lenders, including commercial banks, to significant regulatory restrictions in the name of stamping out predatory lending. Yet there is no evidence that federally regulated banks – national or state -- are a serious part of the problem. Indeed, no fewer than 46 State Attorneys General stated that “predatory lending is perpetrated primarily by non-depository lenders and mortgage brokers,” which, “unlike depository institutions, are subject to little regulation by . . . federal agencies.” And in an amicus brief filed recently in connection with litigation over an OTS preemption regulation, 22

State AGs stated flatly that, based on their investigations and enforcement actions, “predatory lending abuses are largely confined to the subprime mortgage lending market and to non-depository institutions,” and “not banks or direct bank subsidiaries.”

This is no more than you would expect in an industry in which loan officers have been brought up to ask searching questions about a borrower’s capacity to repay before extending credit, an industry that is closely supervised by a variety of federal regulators. The truth is that the real perpetrators of predatory lending are neither subject to conventional bank standards nor subject to federal oversight. They are for the most part, as the State AGs have said, unscrupulous and unsupervised mortgage brokers and lenders, whose interest is not assuring the borrowers’ capacity to repay, but to maximize their fees by capturing the borrowers’ built-up equity in their homes.

If this is correct, one must ask why the states and cities continue to include banks within the scope of these laws. Surely there’s a political dimension to it. Kicking banks around has been something of a national pastime since the days of Andrew Jackson. That’s why it’s critically important not only for banks to make legislators aware of where the problem really lies, but to speak out as an industry in condemning those who are guilty of these abusive practices.

There’s another reason for banks to speak out. These laws are hurting their legitimate business, and in the process are throwing up barriers to the availability of good, risk-priced credit to creditworthy borrowers who may not have had access to bank credit in the past. We’ve seen strong evidence that subprime lending has diminished jurisdictions that have adopted such overbroad anti-predatory lending laws – clearly an unintended consequence of these laws. We’ve also seen evidence that in such

jurisdictions the secondary market for subprime loans may have been adversely affected. Fannie Mae and Freddie Mac have severely conditioned their willingness to purchase loans covered by these laws, and some rating agencies have refused to rate securitizations containing loans covered by such laws – thus posing some very real impediments in the national secondary markets. Indeed, after the OCC preempted the Georgia law, Fitch Ratings reversed its earlier decision to suspend ratings of residential mortgage-backed securities containing “high cost” loans originated in Georgia, specifically citing our preemption decision as a justification for its actions. Because it is now willing to rate those securities, additional liquidity is likely to become available in the Georgia mortgage market, with subprime borrowers as important beneficiaries.

As I’ve suggested, there’s much that the industry can do – that it has not done enough of to date – to dissociate itself clearly and emphatically from predatory lending. It can speak with one voice in denouncing such practices, and focus attention on the real bad actors. It can renew and reinforce its commitment to financial literacy, it can provide financial counseling to help those who might otherwise become victimized by predatory practices. It can continue to do its part to identify abuses, to develop best practices, and to communicate the results of that effort to the American people. Banks are clearly not part of the problem. They have to demonstrate that they are part of the cure.

Is it possible to identify other areas where actual or potential abuses might give rise to the kind of legislation we have seen in the areas of privacy and predatory lending? Let me suggest a couple – credit card practices and “bounce protection” programs.

The United States has the most successful credit card industry of any country in the world, and I am proud to say that the real leaders in this industry are some of our

national banks. The development of credit cards has been of enormous benefit to consumers. But unfortunately not all card issuers have the same kind of commitment to high standards that the best players in the industry have. In fact, no retail banking activity generates more consumer complaints – and where there are persistent and serious complaints, there is a fertile seedbed for legislation.

Consider, overline practices. At one time if a cardholder exceeded his approved credit line the charge would be rejected at the point of sale. Today it is common for the card issuer to honor the charge and assess a penalty on the customer for the overline. It is also common, however, for the issuer not to require prompt payment of the overline amount and not to adjust the minimum monthly payment to take account of the overline. Thus, the overline penalty may continue to accrue month after month. One might ask at what point the creditor who has not required prompt repayment of, and has thus acquiesced in, the overline and has de facto increased the line. And if, as a practical matter, the line has been increased, is it unfair or deceptive for the creditor to continue to impose an overline “penalty”? One might also ask whether customers are being given adequate disclosure in situations such as these. At least one state has attempted to address these issues legislatively, and others may well see this area as an appealing one for future legislation.

Similar questions could be raised about some “secured” credit card programs marketed to people with poor credit histories. A common feature of many such programs is that the available credit is virtually exhausted with front-end fees, charges and “security” deposits, leaving the card holder with no real credit and a sizable account

balance. The absence of complete and meaningful disclosure often heightens the abusive nature of these programs.

The industry's leaders in this field should be speaking out on these issues – if not merely to protect customers from the misconduct of a few, then as a matter of enlightened self interest, to avoid getting themselves tarred with the blame.

“Bounce protection” is another accident waiting to happen. Of course, conventional overdraft protection programs have been part of the banking scene for many years. But today we see some vendors aggressively marketing new programs to banks under which overdraft protection would be affirmatively promoted as a variety of short-term credit, much like the product offered by so-called payday lenders. These programs take a wide variety of forms, and, done right, can clearly serve a very useful need. But there are also opportunities for abuse, and once again there is a danger that the shoddy practices of a few could result in regulatory burdens for everyone.

In this regard, I want to congratulate your incoming Chairman, Ken Fergeson, for his statesmanship in identifying this subject as an issue deserving of comment. One of his earliest actions as Chairman-Elect was to send a letter to all bank CEOs on the subject of bounce protection, cautioning them about the need to treat customers fairly and to provide them with clear, conspicuous disclosures. First and foremost, Ken wrote, consider “how your program will be seen and judged in your community, in the [regulatory] agencies and in court. He set out a list of steps a bank considering such a program should take to protect itself and its reputation. If you ignore these considerations, he warned, your program “could become your worst enemy.”

The most significant thing about Ken's letter was not its substantive advice, which was clearly sound and wise, but the fact that a distinguished banker, in the process of taking over the helm of the industry's largest trade association, took on a leadership role in speaking out forthrightly and frankly on an emerging issue of importance – recognizing that if the issue were to be left unaddressed there could be unhappy consequences for the industry. This was a significant event, I submit, because of what it implies as a potential role for this great association.

Industry self-regulation, of the sort I pondered in that article 25 years ago, might be unrealistic to expect. But one does not need to embrace full-blown self-regulation to see that there is an important role for the industry to play here. There is no reason why, with enlightened and forthright leadership, the industry could not serve both itself and its customers very well by taking on a more organized role as a promulgator of standards and promoter of best practices. To do so would be a dramatic demonstration that the responsible members of the industry – far and away the largest number of institutions – really care about standards of good conduct and are willing to speak out themselves, rather than wait for draconian governmental remedies.

So here is my challenge to the ABA and its new leadership: Create, either yourselves or jointly with other industry associations, an industry Committee on Banking Standards and Practices, to be composed of a group of the most respected people in the industry. The mission of the Committee would be to study, articulate and promote the adoption of principles of fair dealing and to assemble and disseminate information about best practices. Just as Ken Ferguson set out in his letter a series of cautions for banks considering bounce protection programs, the Committee on Banking Standards and

Practices would serve as a forum for addressing issues of importance to the relationship between banks and their customers and as a means for identifying and collecting information on emerging issues.

The Committee need not have mandatory enforcement powers or the ability to impose sanctions. Its effectiveness would depend solely on the logic, common sense, practicality, credibility and moral force of its statements, and on the recognition of its members as individuals of great experience and impeccable reputation. I suspect each of us could identify half a dozen such individuals quite readily. The overriding objective of the Committee would be to demonstrate to the public, to regulatory policymakers, and to legislators that the banking industry is concerned about standards of conduct and is willing to address the subject in an institutional way.

I am not so naïve as to think that there wouldn't be problems setting up such a committee, and I'm sure each of you has thought of some as I have been speaking. But that is not a reason not to make the effort. Done right – with integrity, thoughtfulness, evenhandedness and credibility -- the establishment of such a group could have tremendous benefits for both banks and their customers. And if it is done right it could help stem the tide of regulatory measures that has been swamping the industry.

In the final analysis, of course, no standard setter – indeed, no regulatory or enforcement mechanism – can be a fail-safe against misconduct. In any organization, large or small, there will always be the potential for abuse, and that potential will increase in direct proportion to the pressures that lower-level employees feel to romance customers, to take business away from competitors, and to produce profits at any cost. That is the overriding lesson of recent times, when we have seen even some of our best

managed companies embroiled in the kind of controversy that not only tarnishes their reputation but impacts their shareholders' interests because of the conduct of a miscreant few. The ultimate protection for all of our banks, and the people responsible for running them, is to instill in all employees a dedication to the highest standards of fairness and ethical dealing; to make clear that no loan, no customer, no profit opportunity, is worth compromising those standards for; and to take swift and decisive corrective action where those standards are violated. For an industry whose very survival depends on preserving the confidence, trust and good will of its customers, no less is required.