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Acting Comptroller Julie L. Williams Urges Vigilance in Managing  
Consumer Lending

ORLANDO -- Acting Comptroller of the Currency Julie L. Williams urged bankers to exercise vigilance in managing consumer loan portfolios, warning that retail lending may no longer be the safe haven that bankers traditionally have counted on to help weather financial downturns.

The growth in consumer lending, she said during a speech to the annual convention of the American Bankers Association, can be a "win-win" situation in which consumers benefit from expanded credit opportunities and banks benefit from diversification, increased fee income and new customer relationships.

"But no one wins when individuals receive too much credit or credit they cannot afford," Ms. Williams said. "No one wins when a consumer falls behind or declares personal bankruptcy or loses a home to foreclosure. And, ultimately, no one wins when, in the name of competition, a bank makes a loan that is not fairly priced -- for both parties to the transaction."

"Between 1993 and 1998, consumer credit outstanding -- excluding mortgage debt -- rose more than fifty percent, reaching more than one and a quarter trillion dollars," said Ms. Williams. Debt service payments as a percentage of disposable personal income are near record levels. At the same time, personal bankruptcy has soared: last year, 1.4 million Americans filed to have their personal debts discharged, an increase of more than 100 percent over 10 years.

"What makes this trend particularly worrisome is the fact that more families are struggling to keep up with their debt obligations in the midst of one of the greatest economic expansions in American history, with unemployment at a thirty year low," she said.

"Given the mixed performance of consumer loans during this expansion, it seems likely that consumer loans in the next downturn may prove to be something other than the safe haven they have been in the past," she added. "And that's a possibility that should concern all bankers."

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Bankruptcy reform may prevent consumers from becoming overextended and then walking away from their debts, she said. "But if and when bankruptcy reform does pass, it may also have the effect of shifting the spotlight onto the behavior of lenders, which cannot be said to be beyond reproach."

Some lenders have continued to exercise restraint and common sense, Ms. Williams said. "Other lenders have aggressively

targeted those consumer groups most likely to be seduced by easy credit: college and even high school students; recent bankrupts; and people who are already overextended. Some issuers have exploited loopholes in the law to get unsolicited credit cards into customers' hands; others resort to heavy-handed and sly marketing practices, such as teaser' interest rates."

A particular area of concern is the fast-growing home equity market, where lending standards are continuing to erode, according to the OCC's most recent survey of underwriting trends.

"While competition is steadily driving prices down, the risks of home equity lending are increasing as bankers drill deeper and deeper into the customer pool and base lending decisions on the value of the collateral, rather than the potential borrower's ability to service the debt," she said.

"Indeed, the fastest growing part of this market has been in precisely that part where the risk is greatest, in high LTV and subprime home equity loans -- categories which have more than doubled in volume in just two years," she added.

"Today, these credits may appear to be adequately collateralized. But there may come a time when real estate markets no longer support even existing levels of debt, when borrowers will not or cannot pay, and bankers find it problematical to convert that collateral into cash. Given the high costs of foreclosure and remarketing, that portion of any mortgage loan -- first or second -- that exceeds 85 to 90 percent of the home's appraised value is tantamount to unsecured credit at secured prices -- a bargain no sensible banker should accept," Ms. Williams said.

Ms. Williams said the "crucial caveat" in the subprime and high loan-to-value, or LTV markets, is sound underwriting and administration. It makes no sense to extend 125 percent LTV loans to subprime borrowers, she said, or to fail to price for the additional risks that these loans entail.

"By maintaining the high standards of the banking profession -- standards that uniquely distinguish bankers from other purveyors of financial services -- you not only help your institutions, your industry and your customers. You also provide a great service to this country's economic stability and an essential solid foundation for our future economic growth and prosperity," she concluded.

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