Remarks by
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I am very pleased to have this opportunity to speak with you this afternoon. Compliance is a formidable challenge for bankers these days -- you don't need me to tell you that. Compliance requirements are many, and many of those requirements are detailed and technical. But compliance also has more dimensions than simply satisfying a complicated set of disclosure requirements. Compliance issues also touch on essentials of bankers' relationships with their customers, on their commitment to treating customers fairly, and on their fundamental principles for customer service.

Compliance is an essential -- but not the exclusive -- element of a bank's overall strategy for good customer service. Individual consumers may not know precisely if their bank has complied with all the applicable compliance rules, but they immediately know, and have no problem reacting, when they feel they haven't been treated right by their bank. What I'll talk about today is a question that is at the intersection of compliance and customer service --

When do marketing practices reach the point that they are not just bad customer service, but also unfair or deceptive practices contrary to law?"

First, I'll describe the contexts where we see this issue coming up. Next, I'll describe some steps the OCC has taken to address practices that we felt were unfair and deceptive. Then finally -- and most importantly -- I'm going to offer some guidance on how to *avoid* this type of compliance and customer service problem. Today, the OCC is issuing an Advisory Letter as part of our efforts to identify potentially problematic practices and provide guidance to national banks on how to avoid them. I'll be describing that Advisory Letter as part of my remarks today.

<u>Background</u>

Let me begin by describing a bit of the current environment that can give rise to these issues.

Banks' reliance on non-interest income has grown significantly during the 1990's, and has increased to almost half of the operating income of many commercial banks in recent years. Non-interest fee income is being generated from new sources in an ever-expanding array of products and services that banks offer. At the same time, competition to establish -- and retain -- customer relationships is greater than ever before. Banks recognize the importance of increasing their product offerings to their existing customers, while, at the same time, it has become easier for customers to switch to another financial institution that appears to offer them a better deal.

One way in which banks are competing is by doing more and more marketing. For example, general mailings of credit card solicitations have grown more than fourfold in recent years, to approximately 4.9 billion (or 39 per household) in 2001. Advances in information technology, and the greater availability and sophisticated use of credit bureau information, have made "pre-approved" solicitations for credit cards commonplace in many, many American households. Banks also supplement their own efforts by using agents, like telemarketers, to market the bank's own products and services, and by enabling third party vendors to offer their products and services to bank customers.

These developments create increased risk that a bank, or an agent or vendor that a bank uses, may engage in over-aggressive marketing efforts, that may cross the line and become unfair or deceptive acts or practices. One consequence of this is that the bank may be exposed to liability from private lawsuits or government enforcement actions. Equally important, engaging in these practices undermines a bank's reputation for fair treatment and fair dealing with its customers, and, as a result, harms its ability to retain customers and preserve valuable sources of income.

OCC Authority to Address Unfair or Deceptive Acts or Practices

When a bank's marketing practices cross the line from being bad customer relations to become unfair or deceptive practices, the OCC (and the other federal banking agencies) have authority to intervene. Provisions of the Federal Deposit Insurance Act allow the OCC to initiate cease and desist proceedings and to take other appropriate enforcement actions against a bank if the bank has violated any "law, rule, or regulation."

One *law* that can be violated by banks is section 5 of the Federal Trade Commission Act. This provision declares, in sweeping terms, that "unfair or deceptive acts or practices affecting commerce ... are unlawful." The FTC Act also expressly provides that the Federal Trade Commission may take actions to prevent violations of section 5 *by nonbanks*, but it does not refer explicitly to the authority of any banking agency to enforce section 5 against banks. In addition, another section of the FTC Act requires the Federal Reserve Board to issue regulations defining specific acts and practices by banks as unfair or deceptive, which would be enforced by the banking agencies.

The question that has been raised recently is whether banks can be held accountable by the banking agencies for violations of section 5 of the FTC Act itself -- or only for violations of a Federal Reserve Board regulation that provides that a specific practice is unfair or deceptive. The answer to that question, from our perspective, is clear just by looking at the FTC Act itself. The Act does not exempt banks from its prohibition on unfair or deceptive practices nor does it provide that enforcement of FTC Act *regulations* is the *exclusive* method for enforcing the FTC Act.

The answer also is clear if you look at the legislative history of the FTC Act and its amendments. The legislative history does *not* suggest that when Congress amended the FTC Act to let the Federal Reserve Board issue regulations, it intended to cut back on the authority the banking agencies already had to enforce the general ban on unfair or deceptive practices in section 5. If Congress had intended that, the OCC, FDIC and the Federal Reserve would be left powerless to prevent a bank from engaging in blatantly unfair or deceptive practices that harmed consumers, until the Federal Reserve Board issued a regulation declaring those specific practices to be unlawful under the FTC Act. It is simply implausible that Congress would have intended to create such a void.

To put it simply, we believe that if a bank engages in a practice that is unfair or deceptive under the FTC Act, but that has not been defined as such in a Federal Reserve Board regulation, it has nevertheless violated a "law" and the banking agencies can use their enforcement authority to address the violation.

Recently, three courts have issued decisions that support this position. The Rhode Island Superior Court has expressly recognized the OCC's authority to enforce section 5 of the FTC Act in two rulings. In reaching its decisions, the court also noted the need for uniformity in national banking policy as an additional policy reason for not imposing different State standards on national bank operations and regulatory oversight.

Two *federal* courts also have rendered decisions that recognize the OCC's authority to enforce the FTC Act. The first, Roberts v. Fleet Bank, was a decision issued in November by the U.S. District Court for the Eastern District of Pennsylvania. The second, State of Minnesota v. Fleet Mortgage Company, was a decision issued in December by the U.S. District Court in Minnesota.

Standards that Apply to Deceptive Practices

I imagine that you might now be thinking: "Well, what *standards* determine if a practice is unfair or deceptive if that practice isn't specifically described in a regulation? That's a very fair question to ask. Today the OCC is issuing an Advisory Letter on Unfair and Deceptive Acts and Practices that will help provide some answers. The Advisory Letter describes in detail what our standards are, and how they are derived from the *published precedent* of the Federal Trade Commission in its enforcement of the FTC Act. The primary source material for FTC policy under the FTC Act is their two policy statements -- the Policy Statement on Deception issued in 1983, and the Policy Statement on Unfairness issued in 1980.

To give you a frame of reference, it might be useful for me to take a moment and briefly describe these standards. Under FTC precedent, *deception* exists when a party's representations or omissions are likely to mislead consumers in a material way. According to the Policy Statement and the OCC Advisory Letter, three elements need to be met to find an act deceptive.

First, to be deceptive, the act or practice does not need to actually mislead -- it just needs to be likely to mislead. So, a showing that consumers were actually misled would not be necessary. Instead, in determining if something is likely to mislead, one must consider the overall impression created by the representations or omissions of information to see how they reasonably could be interpreted. In fact, under FTC principles, fine print disclosures of critical information will not necessarily prevent marketing materials from being deceptive if the overall impression of the materials is deceptive and if consumers are unlikely to read the fine print or be able to understand it.

Second, something is likely to mislead if it is likely to mislead a *reasonable* consumer. Under FTC precedent and our Advisory, the reasonable consumer is a consumer from the class of people to whom the advertisement or solicitation is directed. So, it is also necessary to consider the issue in the context of the group targeted by the particular act or practice.

Finally, any deception needs to material. "Materiality" means that the deceptive omission or representation is likely to affect the customer's decision about the product -- particularly, if it concerns the cost of the credit product or some other key consideration. Practices that can be misleading or deceptive in a material way include misleading claims about costs of services or products; use of bait and switch techniques; and failure to provide promised services.

A practice also may be found to be *unfair* and therefore unlawful under section 5 of the FTC Act generally if the net effect of the practice is to cause substantial consumer harm that could not reasonably have been avoided by the consumer.

<u>OCC Enforcement Actions Involving Section 5 of the FTC Act</u>

So, how does the OCC become involved in these issues? During the course of a regular safety and soundness or compliance examination, through consumer complaints, or through referrals from state authorities, the OCC may become aware of practices by a national bank that may be unfair or deceptive. When these situations surface, the OCC applies the FTC Act standards that I just described. And, we have taken action to address situations where we have found violations.

Almost two years ago, the OCC first used its authority under the FTC Act to take action against a national bank that we determined had engaged in deceptive marketing of credit cards targeted to borrowers with weak credit histories. Let me list a few of the practices that we concluded had "crossed over the line."

The bank used telemarketers who promoted "maximum savings" for consumers who transferred balances and took out a credit card from the bank. But, the interest rates consumers actually received on the bank's card were lower by only three tenths or seven tenths of one percent. If consumers asked for more information about how much the savings would be if they transferred their balances, the telemarketers were instructed not to provide it. And, customers who were dissatisfied with their new rate were charged a *previously undisclosed* 3% balance transfer fee if they then closed their account at the bank.

The bank also offered a "Credit Protection" program in connection with its credit cards. By enrolling in this program, customers could avoid making payments for up to 18 months if they became hospitalized or lost their jobs. However, the marketing materials never disclosed several significant restrictions on the program. For example, coverage for involuntary unemployment was available only when the customer had paid 3 months of premiums, and coverage was limited to the number of months paid in -- which could be considerably less than the 18 months' coverage that was promoted.

As just one more example of the problems we found, the bank marketed one of its cards as a "no annual fee" card, but did not adequately disclose that, to get the card, the customer was required to purchase Credit Protection coverage -- which had an *annual cost* of $156. Consumers that refused to pay for Credit Protection were instead charged an annual fee for the card.

The bank in question entered into a settlement of this matter with the OCC in June of 2000. The consent agreement provided for the bank to pay more than $300 million in restitution to its customers, and for the bank to institute a number of changes to its marketing practices.

The most recent enforcement action by the OCC under the FTC Act was in December of 2001. In that action, we determined that the bank in question also had engaged in deceptive practices with respect to marketing its secured credit card. The bank marketed a credit card to subprime borrowers emphasizing that the card would have a credit line of between $250 and $600; that is could be used for "instant cash;" and that it would have "worldwide acceptance." The bank also said that the card would help borrowers to "be prepared for emergencies."

Despite these marketing claims, roughly 80% of applicants received a card with a credit line of the minimum $250. Upon approval, $200 was charged to this credit line for the required savings deposit, and other fees up to $56 also were charged. As a result, most consumers had no – or even negative -- available credit when the card was issued. As you might imagine, the OCC received a number of complaints from consumers who had believed the marketing claims that they would have a credit card that they could actually *use.*

<u>How Banks Can Manage the Risks</u>

Let me be clear that while I do *not* think there is a widespread problem among banks, we all should be concerned about marketing practices that could be unfair or deceptive. Not only do these practices harm consumers, they also can pose significant risks to a bank's reputation, its pocketbook, and ultimately, its safety and soundness. The consequences of engaging in these practices can include expensive litigation, enforcement actions, and monetary judgments.

We are issuing our Advisory Letter on Unfair and Deceptive Acts and Practices to help national banks avoid being placed in that kind of jeopardy.

This leads me to offer some common sense tips, or "best practices" if you will, derived from that Advisory Letter, that you might want to consider to manage your institution's marketing programs:

- As part of your *routine* risk management, review marketing materials for accuracy and to ensure that they fairly and adequately describe the terms, benefits, and material limitations of the product or service being offered. Don't paint a rosy picture in your marketing that is belied by fine print or the terms that are actually likely to be offered. It's important for consumers to receive the information they need about products or services -- including any material limitations -- without having to do "detective" work or hunt for a magnifying glass.

- If there is a significant possibility that consumers will not receive the terms that have been advertised, that possibility should be made apparent, and you should avoid using terms that might suggest otherwise, such as "fixed for years," "guaranteed," and "pre-approved." A clear, up-front disclosure describing any contract provision that allows you to change the credit terms you have agreed to will go a long way toward preventing customer confusion and, possibly, litigation.

- If you promote a product or service by highlighting particular benefits, make sure that the benefit won't be cut off by exercising a contractual change-in-terms provision or by some other aspect of the transaction. As I mentioned, the OCC found that a bank engaged in deception when it promoted a credit card as having "no annual fees," but required the borrower to purchase a credit protection product for $156 a year.

- As another part of sound risk management, get clear and affirmative consent from consumers if you sell products and services through telemarketing.

- If you offer "free trial periods" in connection with products or services, make it clear if the consumer will be required to cancel the service at the end of the trial period to avoid being billed for service past the trial period.

- And, finally, make sure you have appropriate procedures in place to ensure that consumer complaints and other communications are reviewed for indications that consumers might have been misled.

Conclusion

A challenge bankers face today, in an increasingly competitive business, is to not fall victim to a lowest common denominator approach to marketing -- in other words, "my competitors are doing this, why shouldn't I?" The answer to that question ought to be obvious. This is not just a compliance issue. Your customers are your bank's lifeblood. Gaining them and *retaining* them goes to the heart of your future business. Institutions that engage in unfair or deceptive acts or practices will be held accountable -- accountable through judgments and penalties *and* accountable through loss of customers and public trust.

As I said at the outset, consumers may not know if particular activities are contrary to legal standards, but they *do* know when they feel they have been misled or haven't been treated right -- and they can easily switch their business to another institution. In fact, many of the consumers that were affected by the deceptive practices at issue in the enforcement actions I described, did just that.

Banks not only can meet this challenge, they can surpass it. We should not expect consumers -- even financially sophisticated consumers -- to have to read marketing and other information for hidden meaning, or obliquely stated conditions and limitations, as if they were trained investigators -- or heaven forbid -- lawyers. Instead, banks can use their position as trusted and highly respected businesses to promote first class customer relations and the highest integrity in marketing practices for financial products and services.

Take a look at the guidance in our new Advisory. Review your marketing materials and practices, and take the steps you need to “get it right.” It will help keep you out of trouble -- and it’s good business.

Thank you very much.