



NEWS RELEASE

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**Remarks by
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before the
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I am sure all your speakers begin their remarks by telling you how happy they are to be addressing you. I am no different in that respect, but I am particularly sincere in saying that, because this speech provides an opportunity to knit together several important subjects in the retail banking arena: the significance of the retail banking business today and some particular concerns we have with how it is being conducted; how those concerns interact with broader supervisory and regulatory policy perspectives of the OCC; and thoughts on potential consequences for the industry of the convergence of questionable retail banking practices with our supervisory and policy concerns and objectives.

We are talking about an enormously important segment of the banking business today. The consumer accounts for no less than two-thirds of all U.S. economic activity, and it's widely agreed that the extent to which consumer confidence bounces back -- as it appears to be doing -- after its recent decline will go far in determining the magnitude and duration of the economy's recovery.

Consumer attitudes and behavior are also of profound importance to the banking system -- and always have been. But consumer behavior now affects the financial services industry more directly than ever before. During the past two decades, the growth in loans to individuals -- and the declining prominence of commercial and industrial loans -- have been perhaps the most dramatic of the many changes that have occurred in bank portfolios. At the same time, banks have grown increasingly reliant on non-interest income, derived increasingly from their retail customers. In 1983, banks earned nearly nine dollars in interest income for every dollar of non-interest income. In 2001, the ratio was down to less than three to one.

So while unemployment rates, wage growth, housing prices, household debt burden, and other consumer-related measures have always been full of meaning for banks, they have never had a more immediate bearing on the industry's bottom line than they do today.

Given this reliance, one might assume that banks would be bending over backwards to cultivate and retain their retail customers. Indeed, some are – and the effort is usually well rewarded. But we have observed too many banks engaging in retail banking practices that are hard to defend, either from consumer protection or safety and soundness perspectives. Bankers who invent new fees to impose on consumer transactions, or who arbitrarily raise their existing fees, or who engage in fine-print slight-of-hand about how those fees are calculated and applied, risk alienating customers and driving them into the arms of non-bank competitors.

The loss of retail customers en masse would be a serious blow to any business that depends upon them as much as depository institutions do today. But taking those customers for granted – or being insensitive to *their* needs and interests -- presents additional risks to the industry. When retail customer practices by some institutions are abusive, unsavory, unfair, deceptive or unsafe and unsound, those practices may provoke a legislative response -- or a reaction from bank regulators -- that will affect all the institutions engaged in that line of business. The result might be a loss of flexibility by all, and costly new burdens on an entire banking sector. And, in the broadest sense, consumer-unfriendly banking practices are counterproductive to the country's economic recovery.

I know that last point might strike some as a stretch. But when we were checking the latest report on consumer attitudes from the University of Michigan, we happened upon another report prepared by researchers at the same institution, which concluded that customer satisfaction was the most important leading indicator of consumer spending – more important than income changes and consumer confidence combined.

Think about that for a moment. If these researchers are right, then the quality of the interaction between consumers and merchants does more to determine whether that consumer keeps coming back for more – and continues to do his or her part to fuel the economy – than anything else. In other words, it appears that for a significant percentage of the American public, unpleasant, unproductive, or disillusioning retail experiences can have a chilling effect on future spending – depriving the economy of the stimulus from which it would otherwise benefit.

These macroeconomic considerations buttress the case for vigorous supervision of retail banking activities – for the benefit of banks and their customers – and for prompt and decisive supervisory intervention when we find patterns of conduct incompatible with safety and soundness, as well as with the letter and the spirit of consumer protection laws.

Unfortunately, questionable practices are not rare – especially in the credit card business, which generates more customer complaints than any other retail banking activity. That's been the case since the OCC began collecting and tabulating customer complaints relating to national banks in the late 1990s. But consumers with credit card-related complaints have become more vociferous -- and the issues they raise more serious – over the past several years.

Certainly the OCC has taken these complaints seriously – and has acted vigorously to combat the abuses that we discover. In 2000, we investigated charges that Provident National Bank was engaging in unfair and deceptive credit card marketing practices –

practices that affected literally hundreds of thousands of customers. To resolve that dispute, Provident entered into a consent decree that not only assured that the practices we cited would come to a halt, but also provided hundreds of millions of dollars in restitution to customers who had suffered harm. In the last half of 2001, we arrived at similar consent decrees with two other national banks found to have engaged in “unfair and deceptive” practices in their credit card operations. And a fourth national bank whose business was predominantly credit-card related was closed early in 2002 after its unsafe and unsound practices depleted its capital.

These actions, I think, demonstrated our strong commitment to protecting consumers, to upholding the reputation, as well as the safety and soundness of the national banking system, and to safeguarding the public interest. Yet, as already noted, there was continuing and growing evidence – reported both by consumers and our examiners -- that the problems that I’ve just mentioned -- and the practices that gave rise to them -- were becoming sufficiently pervasive industry-wide to warrant a more comprehensive and systematic response.

That’s why the OCC, along with the Federal Reserve, FDIC, and OTS, last year began to develop guidance focusing on account management practices for credit card lending -- issues with safety and soundness as well as consumer protection implications. And this past January, the agencies issued new guidance intended to address those problems. The guidance is significant both for what it says, and because the agencies had to issue it in the first place. I’ll talk about each of these points in turn.

The guidance aimed “to ensure that financial institutions conduct credit card lending in a safe and sound manner by establishing sound account management, risk management, and loss allowance practices.” And it spelled out our specific expectations in each area of concern: credit line management, over-limit practices, minimum payments and negative amortization, workout and forbearance practices, and income recognition and loss allowance practices.

Our concern about **credit line management** stemmed from the growing number of card issuers extending and expanding credit without sufficient consideration of the cardholders’ ability to repay. In some cases, having established a profitable relationship with a borrower, lenders have gone on to increase credit lines or to issue additional cards, including store-specific private label cards and affinity relationships cards, without considering how such extensions might affect that relationship or overextend the borrower’s financial capabilities. It’s not unheard of for institutions to offer additional cards even to borrowers who have already started to experience repayment problems.

The interagency guidance makes clear that lenders must manage credit line assignments and increases responsibly, using proven credit criteria. We expect institutions to test, analyze, and document line-assignment and line-increase criteria, and to establish and strengthen internal controls capable of determining the impact of additional credit lines on repayment capability.

Overlimit practices have been another matter of concern. We have found that account management practices that don’t control the authorization or provide for timely repayment of overlimit amounts may significantly increase the credit risk profile of the portfolio – especially in the case of subprime accounts, where liberal over-limit tolerances and inadequate repayment requirements can magnify the high risk exposure

to the lender.

The guidance stresses the importance of careful management of over-limit accounts, to ensure that bankers are able to identify, measure, manage, and control the risks associated with them. It puts banks on notice to restrict over limit accounts, particularly those that are subprime, and to subject them to appropriate policies and controls.

As regulators, we understand the competitive pressures under which banks operate today. And we understand why banks might see it as advantageous to adopt policies designed to maintain outstanding balances. But some institutions have crossed an important line: they've reduced minimum payment-due amounts on their cards to the point that they fall short of covering all finance charges and fees assessed during the billing period, so that the outstanding balance continues to grow through negative amortization. At the very least, minimum payments set at that level make very little progress in reducing the amount owed.

But such **minimum payment and negative amortization** practices also cross a regulatory line, as our guidance makes explicit. First, reduced minimum payments may have the effect (if not the intent) of masking declining credit quality and borrower impairment. Second, they dig borrowers into an ever deeper hole, requiring increasingly more difficult measures if borrowers are ever to pay their way out of debt.

For those reasons, we expect financial institutions to require minimum payments that will amortize the current balance over a reasonable period of time. Low minimum payments, especially when they result in negative amortization, are not consistent with the principle that consumer loans should be repaid within a reasonable period of time. As the guidance states, negative amortization, inappropriate fees, and other practices can compound or protract consumer debt and disguise portfolio performance. These practices raise safety and soundness concerns and are subject to examiner criticism.

Although it's only been in effect for several months, the guidance has already produced several positive results. It's promoted a greater understanding of the credit risk inherent in over-limit accounts, and has led to a strengthening of over-limit practices. It has generated a useful dialogue with the industry on the adequacy of minimum payments; some institutions that had inordinately reduced their minimums are in the process of raising minimum payments back in line with the industry. It has encouraged the adoption of improved income recognition and loss allowance practices, particularly for uncollectible accrued interest and fees.

But, as important as the content of the guidance is the fact that the guidance had to be issued in the first place. Allow me to elaborate on some lessons to be learned from this development.

At the OCC, we support the ability of national banks to conduct the banking business authorized under their federal charter, including the products they are allowed to offer and the fees they are allowed to charge for them. This assuredly does not mean, however, that we will tolerate abusive or sly consumer banking practices by national banks. We expect national banks to treat their customers fairly and to exhibit the highest standards of integrity in all their business operations. Given the importance of consumer banking business these days, this should be a business imperative. But, where banks fail to do so, we have, and we will take action.

In general, our approach has been to address particular *practices* by particular national banks. Typically, we have tackled unfair, deceptive, unsafe or unsound practices on an institution-specific basis. We recognize that differences in conduct require different sanctions and solutions, and that, on the other hand, different banks could have different, but nevertheless appropriate ways of dealing with a particular consumer issue. Our system of comprehensive supervision of national banks enables us to address -- and not overreact to -- problems we identify. And, we have believed that approaching *practices* through our supervisory process enables us to more effectively deal with the circumstances presented by each bank, and to design solutions customized to the practices, operations and risks presented by each bank.

What is notable about the account management guidance issued earlier this year is that it represents a departure from this approach. More telling is the reason why. To be blunt, some players in the industry have been tone-deaf on key issues. Despite the concerns we have expressed informally; despite the obvious importance of the consumer business segment, some industry participants have looked for any excuse to cut corners in customer treatment and drift to the lowest common denominator of account management practices. Banks should not need to have regulators instruct them on how to fairly treat their customers or fairly present their financial performance. Indeed, in today's post-Enron, post-Sarbanes-Oxley environment, managers of companies of all types should be bending over backwards to assure that presentation of their financial information best reflects the economic substance of their business. The fact that the agencies had to issue the account management guidance reflects a failure to "get it."

At the very least, enlightened self-interest should lead bankers to embrace best practices and condemn any outliers for not doing the same. The history of consumer regulation and legislation teaches a valuable lesson here: When some institutions persist in not "getting it," the consequences ultimately are felt by all institutions, when regulators -- or Congress -- react by setting comprehensive standards that apply to all.

Applying this lesson in the context of the account management guidance is important, because other issues remain, and to the extent the relevant industry continues not to "get it," the industry invites another response from regulators that the industry may well not like. On the question of minimum payments, for example, our guidance did not specify what might be a "reasonable period of time" for an outstanding balance to be amortized. That raises the question of whether the regulatory agencies should impose a limit on the amortization period or require disclosure of the length of time to repay the indebtedness if only the minimum payments are made.

Second, the guidance dealt with the question of negative amortization in the context of minimum payments. But, it can well be argued that negative amortization is a practice that should simply be eliminated. The question is how to do that. A minimum payment that is quite sufficient to amortize the debt alone might be inadequate if over-limit and late fees are added to the financed amount. That would leave financial institutions with two unpalatable choices: either raise the minimum amount or reduce fees.

Third, there are unresolved issues in connection with the repayment of over-limit amounts. Again, part of the problem is definitional: what constitutes "timely repayment" of such amounts, as called for in the guidance? Obviously, over-limit amounts should be subject to more stringent repayment requirements than the original balance. But having

just undergone the process of writing and vetting comprehensive guidance, there is an understandable reluctance, on the parts of the industry and the agencies, to go through the process yet again if satisfactory results can be achieved instead through the supervisory process.

We believe that the supervisory process can produce satisfactory results. For the agencies' part, it requires that we clearly convey our expectations to management. In the coming weeks, our examiners will be doing just that. Whether we wind up having to do more will depend on the industry's response. This is a time for bankers to "get it" -- to demonstrate leadership of their own by reforming their account management practices..

The interagency guidance – and my remarks – have detailed issues arising in connection with credit card lending. But I want to emphasize I could have been talking about other areas of retail banking. Payday lending. Skip payment plans. Debt protection plans. Overdraft protection plans. Each of these banking products has come in for different degrees of criticism. By and large, many of these are not inherently bad or abusive products, and no one would expect bankers to deliver them without being compensated for their effort. Indeed, over the years the OCC has encouraged national banks to look to fee income as a way to diversify their income stream, in order to even out the oscillations in interest income that were so long a source of industry instability. The impressive strength of the banking sector during these trying economic times suggests that this strategy has borne fruit.

But continuing long-term success requires that as bankers pursue more fee-based products and services and enhanced non-interest income, they do so with particular consideration of fairness to customers and fair presentation of their financial performance. Much hinges on the decisions bankers will make regarding the terms on which their retail products are offered and the clarity and integrity with which the performance of those retail products is presented.

You face some important crossroads now in several retail product areas. You have the opportunity to establish a solid foundation for the long-term profitability and success of those products. If you don't, you undermine that foundation, and you enhance the likelihood that regulators will conclude that we need to act, again.

It's up to you.

Thank you very much.

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The OCC charters, regulates and examines approximately 2,100 national banks and 52 federal branches of foreign banks in the U.S., accounting for more than 55 percent of the nation's banking assets. Its mission is to ensure a safe and sound and competitive national banking system that supports the citizens, communities and economy of the United States.