

Remarks by
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It's been said many times and in many contexts: the key to successful banking is treating people – your customers – properly. And so before I plunge in to this afternoon's topic, let me pause to applaud the Consumer Bankers Association for its diligence and effectiveness in promoting high quality customer service practices in the banking business.

That's why I've long been an admirer of CBA and Joe Belew, who leads this organization with vision and distinction. And that's why I'm particularly delighted to have the opportunity to keynote this year's Fair Lending conference, to spotlight a major development that is both a customer service opportunity and potentially, a major compliance challenge and reputation risk for the banking industry.

How does this relate to this conference, which is entitled "Demographics and Data: The Changing Landscape?" Building customer loyalty and providing exemplary customer service is founded on information – information about people's financial needs and goals – and then taking steps to meet them. The more you learn about your customers and where their dreams hope to take them, the better situated you are to shape financial products and services to fit their needs – and help make those dreams a reality. And the more perspectives you have on how you are doing that job, and where you may need to improve, the better positioned you are to adjust your practices to better achieve your goals.

Sometimes you obtain information that presents both opportunity and challenges and risks, and that brings me to my topic for this afternoon. Like it or not, most bankers (and many other home mortgage lenders) have no choice but to address new information on their home mortgage lending performance that will soon become public as a result of changes to the reporting requirements implementing the Home Mortgage Disclosure Act (HMDA).

Many lenders are now collecting, and next year will be publicly reporting, new – and more detailed – data concerning their home mortgage lending business. For the first time, lenders must report pricing information for higher-priced loans by borrower characteristics – race, ethnicity, income level and gender, and the racial and ethnic composition and income level of the census tract in which the property is located.

Reporting is required for higher-priced loans for home purchase loan originations, secured home improvement loans and refinancings. A loan is high-priced and triggers the expanded reporting requirements if the spread between the APR on the loan and the yield on comparable Treasury securities is greater than 3 percentage points for first-lien loans, or 5 percentage points or more for subordinate lien loans.

Also, for the first time, lenders must report on whether a loan is subject to the Home Ownership and Equity Protection Act (which may apply based on the interest rate or the fees charged on the loan), must report on the lien status of applications and originations, and must report on whether the mortgage is for a manufactured home.

Right now, you may not be thinking about these new requirements as an opportunity to understand your customers better. You may not be thinking about them as an opportunity to grow and enhance your business, by obtaining valuable new insight that can help you rationalize your lending and loan pricing patterns, and identify new and unexplored housing markets. And you may be thinking less in terms of how the new data might ultimately reduce your risk than of how it might expose you to risk. All those perspectives have validity, but thinking about the new requirements only from a narrow perspective, strictly as a risk and a burden, would be a mistake.

From the much broader perspective of encouraging home ownership in this nation, economists have said that the reporting requirements of the Home Mortgage Disclosure Act – and I’m quoting here – “have played a critical role” in encouraging low- and moderate-income lending – and thus in identifying and developing new markets for financial institutions in low- and moderate-income communities.” Certainly that was one the implicit goals behind the original 1975 legislation – to bring distortions and disparities in the allocation of mortgage financing to light, in the hope that private self-interest would eventually take over.

HMDA has worked in important respects. As one public interest organization recently put it, HMDA data – and I’m quoting again -- “has significantly increased lending opportunities for communities of color and has enabled lending institutions, community groups, and public agencies to work together to identify and address gaps in lending to [those] communities.”

There’s no doubt, of course, that the new HMDA requirements also present major challenges for bankers.

For financial institutions that now spend what they see as way too much time and energy complying with disclosure requirements, the newest HMDA requirements will undoubtedly represent an unwelcome addition to what feels like an already excessively heavy load. Community banks especially might notice the increase as they make the necessary initial adjustments to their systems to generate the new data.

But if you think things are difficult now, just wait until August 2005, when the new data becomes public for the first time. That will be the real test. What will that data

show? What public response will it elicit? And what will the consequences be for regulators and for financial institutions themselves? These are all questions we need to start thinking about now.

We are entering the fourth quarter of 2004. All banks should be doing some form of preliminary analysis of their HMDA data by now. Does your institution have a good idea of what its numbers show? Have you analyzed that data? Are there patterns of inordinate concentrations of higher-cost loans in areas with higher levels of minority borrowers? Are there notable pricing disparities between apparently similarly situated borrowers of a different race, ethnicity or sex? Have you asked why? What is the answer? Can you back up that explanation? Should the data be a catalyst for scrutiny of or changes in your practices in order to better achieve your institution's lending goals? What is your process to make these decisions? How involved is senior management and the board of directors?

What worries me here is that this may be yet another case in which such a failure of preparedness – a failure, if you will, to anticipate and understand consequences – will wind up being enormously costly, not only for individual financial institutions, but for the entire banking industry. The exposure here is not necessarily dollars out-of-pocket – although that may well be the case – but the loss of a more precious and consequential commodity – the good name of your institution and the reputation of banks at large.

A variety of recent events have illustrated how a failure to adequately address a compliance risk issue can create reputation risk implosion that can wound an institution's business prospects, torpedo its stock price, and in some cases prove mortal to its ability to continue an existing franchise. And, unfortunately, we're all too familiar with situations in which behavior involving a relatively small number of industry participants can lead to very sweeping and very burdensome legislative and regulatory responses that significantly impact the entire industry.

Some of you may recall that about six years ago – at another CBA conference – I discussed this same type of concern in connection with customer privacy and information security. This was a subject that not many bank regulators were talking about at the time. I suggested that the industry needed to confront the issue early, rise to the challenge of self-regulation and meet the growing demand of the banking public for comprehensive and effective privacy protection. My concern then was that, without pro-active steps by industry, government would be compelled to step in. And we all recognized that such government-imposed safeguards would come at a cost: there would be restrictions and disclosure requirements that would reduce access to customer information and make that information harder to come by and more cumbersome to use than the industry would wish.

I take no pleasure – nor, I'm sure, do you – in assessing where we are now on this issue.

I also recall a speech delivered in 1998 on customer service and competition. I stressed the importance of customer service to a banking franchise and suggested then that because the public did not necessarily perceive banks as outstanding service providers, the industry was not faring as well in the legislative arena as other financial providers. I challenged bankers to improve their performance, particularly by taking a more enlightened approach to service fees, which were then the source of the largest number of consumer complaints. Relatively small-dollar adjustments and more transparency on the industry's part, I thought then, might pay disproportionate dividends if public antipathy toward banks were neutralized and the industry finally found itself in an improved position to achieve its long-term legislative goals. I will leave it to you to ponder where we are on that front.

Certainly the last six years have demonstrated -- repeatedly and decisively -- that an internal risk management regime that fails to flag threats to a bank's reputation and then to bring those threats to the attention of the board of directors and senior management is a most inadequate risk management system indeed.

Now we're facing the distinct possibility that the industry could be in for trouble again if the new HMDA data leads the public to conclude that financial institutions are engaging in discriminatory lending based on race, gender or ethnicity. Some observers are predicting that the release of the new data next August will be followed by lawsuits charging that lenders are targeting minorities for high-cost or predatory loans. But, if the new HMDA data do nothing more than show concentrations of high cost loans in minority neighborhoods, the burden nevertheless will be on the lenders to show that this resulted from nondiscriminatory credit decisions.

One can easily envision that some costly litigation may result, or that new legislative initiatives may be spurred, if the public reports show racial disparities in loan pricing. But the reputational damage to individual institutions and to the industry could be still worse.

Bankers should not be sitting on their hands. And, at the OCC, we are not waiting until next August to act.

We are in the process of contacting a group of national banks that includes high volume home mortgage lenders, those with an emphasis on subprime lending, and those with previously identified compliance weaknesses in their mortgage lending operations. We will be asking those banks whether they have analyzed their HMDA data through the first and second quarter of 2004. We will ask them what techniques they are using in that analysis. We will *tell them* that if they have not begun to analyze that data, they must begin. And we will alert them that *we* may undertake to do an early analysis of their data.

If and when we receive evidence -- from HMDA reports or any other credible source -- suggesting that violations of the fair lending laws might be taking place at an institution under our jurisdiction, we will increase the level of our supervisory oversight

accordingly. If we discover that discriminatory practices have in fact taken place, we will respond appropriately and forcefully.

Of course, our hope is that bankers – those who may read my words as well as those of you who are listening to them today – will heed the message and take steps now to evaluate your own data, identify areas that raise questions, and discover the answers to those questions.

If you find a problem – correct it! Better you find it and correct it promptly, than we find a festering problem and have to order that it be corrected.

But, I don't wish to end these remarks on a discouraging note. I truly believe what I said at the outset: that for bankers, knowledge – and information – is power and holds the key to improved customer service and responsiveness. The more you know about your customers, the better you can serve them. That's why I believe that the expanded HMDA reporting requirements should be viewed, first, as a tool that can be useful – just as they've been useful in the past – for financial institutions seeking to expand business opportunities in America's mortgage markets.

The rise in our nation's homeownership rate – now approaching 70 percent – has to be one of the great success stories in the history of our financial system. That success, too, owes in part to the fact that borrowers and lenders and investors in the secondary markets enjoy access to the information they need to make considered choices, and greater transparency helps prevent disparities in the treatment of borrowers. Stable communities, safer environments in which to build families, and a stronger and more stable America have been the result.

But we should never forget that many of our recent accomplishments as a nation in the area of home ownership would not have been possible had lenders persisted in patterns of the past – ways of doing business that were traditional, but today may be illegal. To bring the American Dream of home ownership within reach of even more of our people – to keep raising our national standard of living – high standards of integrity and fairness in the business of banking must prevail.

The new HMDA data offers a new set of clues on how well each of your institutions is doing. The new data is by no means a dispositive judgment on any bank's lending practices. But it will give bank managers another set of signals about their bank's operations; a set of signals that may point to successes to build on, to issues that should be addressed, or to problems that must be corrected. That's why I said at the outset that these new reporting requirements present bankers with a valuable opportunity.

Don't let it slip away.

Thank you.