

For Release Upon Delivery

**STATEMENT of**  
**JOHN C. DUGAN**  
**COMPTROLLER OF THE CURRENCY**  
**before the**  
**COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS**  
**UNITED STATES SENATE**  
**August 4, 2009**

Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent those of the President.

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**United States Senate**  
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Chairman Dodd, Ranking Member Shelby, and Members of the Committee, I appreciate this opportunity to discuss the modernization of financial services regulation in the context of the Administration's Proposal for regulatory reform.<sup>1</sup> The events of the last two years – including the unprecedented distress and failure of financial firms, the accumulation of toxic subprime mortgage assets in our financial system, and the steep rise in foreclosures – have exposed gaps and weaknesses in our regulatory framework. The Proposal put forward by the Treasury Department for strengthening that framework is thoughtful and comprehensive, and I support many of its proposed reforms. But I also have significant concerns with two parts of it, *i.e.*, (1) the proposed broad authority of the Federal Reserve, as systemic risk regulator, to override authority of the primary prudential banking supervisor; and (2) the elimination of uniform national consumer protection standards for national banks in connection with establishing the newly proposed Consumer Financial Protection Agency (CFPA), and the transfer of all existing consumer protection examination and enforcement from the federal banking agencies to

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<sup>1</sup> See U.S. Department of the Treasury, FINANCIAL REGULATORY REFORM – A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION (June 2009) (the "Proposal"), available at [www.financialstability.gov/docs/regs/FinalReport\\_web.pdf](http://www.financialstability.gov/docs/regs/FinalReport_web.pdf). Treasury also has released legislative language to implement most components of the Proposal. That proposed legislation is available at [www.treas.gov/initiatives/regulatoryreform](http://www.treas.gov/initiatives/regulatoryreform).

the new CFPB. Both concerns relate to the way in which important new authorities would interact with the essential functions of the dedicated prudential banking supervisor.

My testimony begins with a brief summary of the key parts of the Proposal we generally support. The second section focuses on the topics pertaining to regulatory structure on which the Committee has specifically invited our views; this portion includes a discussion of the Federal Reserve's role and authority. The last section addresses our second area of major concern – uniform national standards and the CFPB.

## **I. Key Provisions Supported by the OCC**

We believe many of the Administration's proposed reforms will strengthen the financial system and help prevent future market disruptions of the type we witnessed last year, including the following:

- **Establishment of a Financial Stability Oversight Council.** This council would consist of the Secretary of the Treasury and all of the federal financial regulators, and would be supported by a permanent staff. Its general role would be to identify and monitor systemic risk, and it would have strong authority to gather the information necessary for that mission, including from any entity that might pose systemic risk. We believe that having a centralized and formalized mechanism for gathering and sharing systemically significant information, and making recommendations to individual regulators, makes good sense. It also could provide a venue or mechanism for resolving differences of opinions among regulators.
- **Enhanced authority to resolve systemically significant financial firms.** The Federal Deposit Insurance Corporation (FDIC) currently has broad authority to

resolve a distressed systemically significant depository institution in an orderly manner. No comparable resolution authority exists for large bank holding companies, or for systemically significant financial companies that are not banks, as we learned painfully with the problems of such large financial companies as Bear Stearns, Lehman Brothers, and AIG. The Proposal would extend resolution authority like the FDIC's to such nonbanking companies, while preserving the flexibility to use the FDIC or another regulator as the receiver or conservator, depending on the circumstances. This is a sound approach that would help maximize orderly resolutions of systemically significant firms.

- **Strengthened regulation of systemically significant firms, including requirements for higher capital and stronger liquidity.** We support the concept of imposing more stringent prudential standards on systemically significant financial firms to address their heightened risk to the system and to mitigate the competitive advantage they could realize from being designated as systemically significant. But these standards should not displace the standard-setting and supervisory responsibilities of the primary banking supervisor with respect to bank subsidiaries of these companies. And in those instances where the largest asset of the systemically significant firm is a bank – as may often be the case – the primary banking supervisor should have a strong role in helping to craft the new standards for the holding company.
- **Changes in accounting standards that would allow banks to build larger loan loss reserves in good times to absorb more losses in bad times.** One of the problems that has impaired banks' ability to absorb increased credit losses while

continuing to provide appropriate levels of credit is that their levels of loan loss reserves available to absorb such losses were not as high as they should have been entering the crisis. One reason for this is the currently cramped accounting regime for building loan loss reserves, which is based on the concept that loan loss provisions are permissible only when losses are “incurred.” The Proposal calls for accounting standard setters to improve this standard to make it more forward looking so that banks could build bigger loan loss reserves when times are good and losses are low, in recognition of the fact that good times inevitably end, and large loan loss reserves will be needed to absorb increased losses when times turn bad. The OCC strongly supports this part of the Proposal. In fact, I co-chaired an international task force under the auspices of the Financial Stability Board to achieve this very objective on a global basis, which we hope will contribute to stronger reserving policy both here and abroad.

- **Enhanced consumer protection.** The Proposal calls for enhanced consumer protection standards for consumer financial products through new rules that would be written and implemented by the new Consumer Financial Protection Agency. The OCC supports strong, uniform federal consumer protection standards. While we generally do not have rulewriting authority in this area, we have consistently applied and enforced the rules written by the Federal Reserve (and others), and, in the absence of our own rulewriting authority, have taken strong enforcement actions to address unfair and deceptive practices by national banks. We believe that an independent agency like the CFPB could appropriately strengthen consumer protections, but we have serious concerns with the CFPB as

proposed. We believe the goal of strong consumer protection can be accomplished better through CFPB rules that reflect meaningful input from the federal banking agencies and are truly uniform, rather than resulting in a patchwork of different rules amended and enforced differently by individual states. We also believe that these rules should continue to be implemented by the federal banking agencies for banks, under the existing, well established regulatory and enforcement regime, and by the CFPB and the states for nonbank financial providers, which today are subject to different standards and far less actual oversight than federally regulated depository institutions. This is discussed in greater detail below.

- **Stronger regulation of payments systems, hedge funds, and over-the-counter derivatives, such as credit default swaps.** The Proposal calls for significant enhancements in regulation in each of these areas, which we generally support in concept. We will provide more detailed comments about each, as appropriate, once we have had more time to review the implementing legislative language.

## **II. Regulatory Structure Issues**

### **1. Proposed Establishment of the National Bank Supervisor and Elimination of the Federal Thrift Charter**

In proposing to restructure the banking agencies, the Proposal appropriately preserves an agency whose only mission is banking supervision. This new agency, the National Bank Supervisor (NBS), would serve as the primary regulator of federally chartered depository institutions, including the national banks that comprise the dominant businesses of many of the largest financial holding companies. To achieve this goal, the Proposal would effectively merge the Office of Thrift Supervision (OTS) into the OCC.

It would eliminate the federal thrift charter – and also, as I will shortly discuss, the separate treatment of savings and loan holding companies – with all federal thrifts required to convert to a national bank, a state bank, or a state thrift, over the course of a reasonable transition period. (State thrifts would then be treated as state “banks” under Federal law.) We believe this approach to the agency merger is preferable to one that would preserve the federal thrift charter, with federal thrift regulation being conducted by a division of the merged agency. With the same deposit insurance fund, same prudential regulator, same holding company regulator, same branching powers, and a narrower charter (a national bank has all the powers of a federal thrift plus many others), there would no longer be a need for a separate federal thrift charter. In addition, the approach in the Proposal avoids the considerable practical complexities and costs of administering two separate statutory and regulatory regimes that are largely redundant in many areas, and needlessly different in others. Finally, the legislation implementing this aspect of the Proposal should be unambiguously clear – as we believe is intended – that the new agency is independent from the Treasury Department and the Administration to the same extent that the OCC and OTS are currently independent.<sup>2</sup>

## **2. Enhancement of the Federal Reserve’s Supervision of Systemically Significant Financial Holding Companies**

The Federal Reserve Board already has strong authority as consolidated supervisor to identify and address problems at large, systemically significant bank holding companies. In the financial crisis of the last two years, the absence of a

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<sup>2</sup> For example, current law provides the OCC with important independence from political interference in decision-making in matters before the Comptroller, including enforcement proceedings; provides for funding independent of political control; enables the OCC to propose and promulgate regulations without approval by the Treasury; and permits the agency to testify before Congress without the need for the Administration’s clearance of the agency’s statements.

comparable authority with respect to large securities firms, insurance companies, and government-sponsored enterprises that were not affiliated with banks proved to be an enormous problem, as a disproportionate share of the financial stress in the markets was created by these institutions. The lack of a consistent and coherent regulatory regime applicable to them by a single regulator helped mask problems in these nonbanking companies until they were massive. And gaps in the regulatory regime constrained the government's ability to deal with them once they emerged. The Proposal would extend the Federal Reserve's consolidated bank holding company regulation to systemically significant nonbanking companies in the future, which would appropriately address the regulatory gap. However, as discussed below, one aspect of this part of the proposal goes too far, *i.e.*, the new Federal Reserve authority to "override" key functions of the primary banking supervisor, which would undermine the authority – and the accountability – of the banking supervisor for the soundness of the banks that anchor systemically significant holding companies.

### **3. Elimination of the Thrift Holding Company and Industrial Loan Company Exceptions to Bank Holding Company Act Regulation**

Under the law today, companies that own thrifts or industrial loan companies (ILCs) are exempt from regulation under the Bank Holding Company Act. The Proposal would eliminate these exemptions, making these types of firms subject to supervision by the Federal Reserve Board.

Thrift holding companies, unlike bank holding companies, are not subject to consolidated regulation; for example, no consolidated capital requirements apply at the holding company level. This difference between bank and thrift holding company regulation created arbitrage opportunities for companies that were able to take on greater



risk under a less rigorous regulatory regime. Yet, as we have seen – AIG is the obvious example – large nonbank firms can present similar risks to the system as large banks. This regulatory gap should be closed, and these firms should be subject to the same type of oversight as bank holding companies.

Companies controlling ILCs also are not subject to bank holding company regulation, but admittedly, ILCs have not been the source of the same kinds of problems as thrift holding companies. For that reason, it may be appropriate to continue to exempt small ILCs from bank holding company regulation. If this approach were pursued, the exemption should terminate once the ILC exceeds a certain size threshold, however, because the same potential risks can arise as with banks. Alternatively, if the ILC exemption were repealed altogether, appropriate grandfathering of existing ILCs and their parent companies should be considered.

#### **4. The Merits of Further Regulatory Consolidation**

It is clear that the United States has too many bank regulators. We have four federal bank regulators, 12 Federal Reserve Banks, and 50 state regulators, nearly all of which have some type of overlapping supervisory responsibilities. This system is largely the product of historical evolution, with different agencies created for different legitimate purposes reflecting a much more segmented financial system from the past. No one would design such a system from scratch, and it is fair to say that, at times, it has not been the most efficient way to establish banking policy or supervise banks.

Nevertheless, the banking agencies have worked hard over the years to make the system function appropriately despite its complexities. On many occasions, the diversity in perspectives and specialization of roles has provided real value. And from the

perspective of the OCC, I do not believe that our sharing of responsibilities with other agencies has been a primary driver of recent problems in the banking system.

That said, I recognize the considerable interest in reducing the number of bank regulators. The impulse to simplify is understandable, and it may well be appropriate to streamline our current system. But we ought not approach the task by prejudging the appropriate number of boxes on the organization chart. The better approach is to determine what would be achieved if the number of regulators were reduced. What went wrong in the current crisis that changes in regulatory structure (rather than regulatory standards) will fix? Will accountability be enhanced? Will the change result in greater efficiency and consistency of regulation? Will gaps be closed so that opportunities for regulatory arbitrage in the current system are eliminated? Will overall market regulation be improved?

In testimony provided earlier this year, I strongly urged that Congress, in reforming financial services regulation, preserve a robust, independent bank supervisor that is solely dedicated to the prudential oversight of depository institutions. Banks are the anchor of most financial holding companies, including the very largest, and I continue to believe that the benefits of dedicated, strong prudential supervision are significant – indeed, necessary. Dedicated supervision assures there is no confusion about the supervisor’s goals and objectives, and no potential conflict with competing objectives. Responsibility is well defined, and so is accountability. Supervision takes a back seat to no other part of the organization, and the result is a strong culture that fosters the development of the type of seasoned supervisors that are needed to confront the many challenges arising from today’s banking business. The strength of national banks at the

core of many of the largest financial holding companies has been an essential anchor to the ability of those companies to weather recent financial crises – and to absorb distressed securities and thrift companies.

While there is arguably an agreement on the need to reduce the number of bank regulators, there is no such consensus on what the right number is or what their roles should be. As I have mentioned, we support reducing the number of federal banking regulators from four to three by effectively merging the OTS into the OCC, leaving just one federal regulator for federally chartered banks. There are reasonable arguments for streamlining the regulatory structure even further, but there would be advantages and disadvantages at each step.

For example, the number of banking regulators could be further reduced from three to two by creating a single federal regulator for state-chartered banks, whose federal supervision is now divided between the Federal Reserve Board and the FDIC, depending on whether the state bank is a member of the Federal Reserve System. Today there is virtually no difference in the regulation applicable to state banks at the federal level based on membership in the System and thus no real reason to have two different federal regulators. It would be simpler to have one. Opportunities for regulatory arbitrage – resulting, for example, from differences in the way federal activities restrictions are administered by one or the other regulator – would be reduced. Policymaking would be streamlined. Fewer decisionmakers would have to agree on the implementation of banking policies and restrictions that Congress has required to be carried out on a joint basis.

On the other hand, whichever agency loses supervisory authority over state banks also would lose the day-to-day “window” into the condition of the banking industry that today informs the conduct of other aspects of its mission. This may present a greater problem for the FDIC, which would have much less engagement with the banking sector during periods with few bank failures, especially if the Federal Reserve retained holding company jurisdiction, an issue I discuss below.

Still further consolidation could be achieved by reducing the number of bank regulators to one dedicated prudential supervisor. If this were done, the single federal supervisor should be structured to be independent from the Treasury Department and headed by a board of directors, with the Chairmen of the FDIC and the Federal Reserve Board serving as board members. This is the simplest, and arguably the most logical, approach. It would afford the most direct accountability – there would be no confusion about which regulator was responsible for the federal supervision of a bank – and it would end opportunities for regulatory arbitrage. Moreover, it could be done within the framework of the dual banking system by preserving both state and national charters. It would be desirable, however, for the single regulator to maintain separate divisions for the supervision of large and small institutions, given the differences in complexity and types of risk that banks of different sizes present.

The disadvantages of such an approach include removing both the Federal Reserve and the FDIC from day-to-day bank supervision (although that concern would be mitigated for the Federal Reserve to the extent it retained holding company regulation). In addition, states may be concerned that the state charter would be significantly less attractive if the same federal regulator supervised both state and federal institutions,

especially if state-chartered institutions were required to pay for federal supervision in addition to the assessments charged by the state (although that issue could be addressed separately).

Finally, the Committee has asked whether a consolidated prudential bank supervisor also could regulate the holding company. While this could be done, and has significant appeal with respect to small and “bank-only” holding companies, there would be significant issues involved with such an approach in the case of the largest companies where the challenges would be the greatest.

Little need remains for separate holding company regulation where the bank is small or where it is the holding company’s only, or dominant, asset. (The previously significant role of the Federal Reserve, as holding company supervisor, in approving new activities was dramatically reduced by the provisions in the Gramm-Leach-Bliley Act that authorized financial holding companies and specifically identified and approved in advance the types of activities in which they could engage.) For these firms, the holding company regulator’s other authorities are not necessary to ensure effective prudential supervision to the extent that they duplicate the federal prudential supervisor’s authority to set standards, examine, and take appropriate enforcement action with respect to the bank. Elimination of a separate holding company regulator thus would eliminate duplication, promote simplicity and accountability, and reduce unnecessary compliance burden for institutions as well.

The case is harder and more challenging for the very largest bank holding companies engaged in complex capital markets activities, especially where the company is engaged in many, or predominantly, nonbanking activities, such as securities and

insurance. Given its substantial role and direct experience with respect to capital markets, payments systems, the discount window, and international central banking, the Federal Reserve Board provides unique resources and perspective to supervision. Eliminating the Board as holding company regulator would mean losing the direct effect of that expertise. The benefits of the different perspectives of holding company regulator and prudential regulator would be lost. The focus of a dedicated, strong prudential banking supervisor could be significantly diluted by extending its focus to nonbanking activities. It also would take time for the consolidated banking supervisor to acquire and maintain a comparable level of expertise, especially in nonbanking activities.

#### **5. Delineation of Responsibilities between the Systemic Supervisor and Prudential Supervisor**

If, as under the Administration's Proposal, the Board is the systemic holding company supervisor, then it is essential that clear lines be drawn between the Board's authority and the authority of the prudential banking supervisor. As I will explain, the Proposal goes too far in authorizing the systemic supervisor to override the prudential supervisor's role and authorities.

The Proposal would establish the Federal Reserve Board as the systemic supervisor by providing it with enhanced, consolidated authority over a "Tier 1" financial holding company – that is, a company that poses significant systemic risk – and all of its subsidiaries. In essence, this structure builds on and expands the current system for supervising bank holding companies, where the Board already has consolidated authority over the company, and the prudential bank supervisor is responsible for direct bank supervision.

In practice, many of the companies likely to be designated as Tier 1 financial holding companies will have at their heart very large banks, many of which are national banks. Because of their core role as financial intermediaries, large banks have extensive ties to the “federal safety net” of deposit insurance, the discount window, and the payments system. Accordingly, the responsibility of the prudential bank supervisor must be to ensure that the bank remains a strong anchor within the company as a whole. Indeed, this is our existing responsibility at the OCC, which we take very seriously through our continuous on-site supervision by large teams of resident examiners in all of our largest national banks. As a result, the bank is by far the most intensively regulated part of the largest bank holding companies, which has translated into generally lower levels of losses of banks within the holding company versus other companies owned by that holding company – including those large bank holding companies that have sustained the greatest losses.

In the context of regulatory restructuring for systemically significant bank holding companies, preserving the essential role of the prudential supervisor of the bank means that its relationship with the systemic supervisor should be complementary; it should not be subsumed or overtaken by the systemic supervisor. Conflating the two roles undermines the bank supervisor’s authority, responsibility, and accountability. Moreover, it would impose major new responsibilities on and further stretch the role of the Board.

Parts of the Proposal are consistent with this type of complementary relationship between the Board and the prudential bank supervisor. For example, the Board would be required to rely, as far as possible, on the reports of examination prepared by the

prudential bank supervisors. This approach reflects the practical relationship that the OCC has with the Board today, a relationship that works, in part because the lines of authority between the two regulators are appropriately defined. And it has allowed the Board to use and rely on our work to perform its role as supervisor for complex banking organizations that are often involved in many businesses other than banking. It is a model well suited for use in a new regulatory framework where the Board assumes substantial new responsibilities, including potential authority over some Tier 1 companies that do not have bank subsidiaries at all.

In one crucial respect, however, the Proposal departs dramatically from that model and is not consistent with its own stated objective of maintaining a robust, responsible, and independent prudential supervisor that will be accountable for its safety and soundness supervision. That is, the Proposal provides the Board with authority to establish, examine, and enforce more stringent standards with respect to the “functionally regulated” subsidiaries of Tier 1 financial holding companies – which under the proposal would include bank subsidiaries – in order to mitigate systemic risk posed by those subsidiaries. This open-ended authorization would allow the Board to impose customized requirements on virtually any aspect of the bank’s operations at any time, subject only to a requirement for “consultation” with the Secretary of the Treasury and the bank’s primary federal or state supervisor. This approach is entirely unnecessary and unwarranted in the case of banks already subject to extensive regulation. It would fundamentally alter the relationship between the Board and the bank supervisor by superseding the bank supervisor’s authority over bank subsidiaries of systemically



significant companies, and would be yet another measure that concentrates more authority in, and stretches the role of, the Board.

In addition, while the Proposal centralizes in the Board more authority over Tier 1 financial holding companies, it does not address the current, significant gap in supervision that exists within bank holding companies. In today's regulatory regime, a bank holding company may engage in a particular banking activity, such as mortgage lending, either through a subsidiary that is a bank or through a subsidiary that is not a bank. If engaged in by the banking subsidiary, the activity is subject to required examination and supervision on a periodic basis by the primary banking supervisor. However, if it is engaged in by a nonbanking subsidiary, it is potentially subject to examination by the Federal Reserve, but regular supervision and examination is not required. As a policy matter, the Federal Reserve had previously elected not to subject such nonbanking subsidiaries to full bank-like examination and supervision on the theory that such activities would inappropriately extend "the safety net" of federal protections from banks to nonbanks.<sup>3</sup> The result has been the application of uneven standards to bank and nonbank subsidiaries of bank holding companies. For example, in the area of mortgage lending, banks were held to more rigorous underwriting and consumer compliance standards than nonbank affiliates in the same holding company. While the Board has recently indicated its intent to increase examination of nonbank affiliates, it is not clear that such examinations will be required to be as regular or extensive as the examination of the same activities conducted in banks.

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<sup>3</sup> See, e.g., Chairman Alan Greenspan, "Insurance Companies and Banks Under the New Regulatory Law," Remarks Before the Annual Meeting of the American Council of Life Insurance (November 14, 1999) ("The Gramm-Leach-Bliley Act is designed to limit extensions of the safety net, and thus to eliminate the need to impose bank-like regulation on nonbank subsidiaries and affiliates of organizations that contain a bank."), available at [www.federalreserve.gov/boarddocs/speeches/1999/19991115.htm](http://www.federalreserve.gov/boarddocs/speeches/1999/19991115.htm).

I believe that such differential regulation and supervision of the same activity conducted in different subsidiaries of a single bank holding company – whether in terms of safety and soundness or consumer protection – doesn’t make sense and is an invitation to regulatory arbitrage. Indeed, leveling the supervision of all subsidiaries of a bank holding company takes on added importance for a “Tier 1” financial holding company because, by definition, the firm as a whole presents systemically significant risk.

One way to address this problem would be to include in legislative language an explicit direction to the Board to actively supervise nonbanking subsidiaries engaged in banking activities in the same way that a banking subsidiary is supervised by the prudential supervisor, with required regular exams. Of course, adding new required responsibilities for the direct supervision of more companies may serve as a distraction both from the Board’s other new assignments under the Proposal as well as the continuation of its existing responsibilities.

An alternative approach that may be preferable would be to assign responsibility to the prudential banking supervisor for supervising certain non-bank holding company subsidiaries. In particular, where those subsidiaries are engaged in the same business as is conducted, or could be conducted, by an affiliated bank – mortgage or other consumer lending, for example – the prudential supervisor already has the resources and expertise needed to examine the activity. Affiliated companies would then be made subject to the same standards and examined with the same frequency as the affiliated bank. This approach also would ensure that the placement of an activity in a holding company structure could not be used to arbitrage between different supervisory regimes or approaches.

### **III. The Proposed Consumer Financial Protection Agency and The Elimination of Uniform National Standards for National Banks**

Today's severe consumer credit problems can be traced to the multi-year policy of easy money and easy credit that led to an asset bubble, with too many people getting loans that could not be repaid when the bubble burst. With respect to these loans – especially mortgages – the core problem was lax underwriting that relied too heavily on rising house prices. Inadequate consumer protections – such as inadequate and ineffective disclosures – contributed to this problem, because in many cases consumers did not understand the significant risks of complex loans that had seductively low initial monthly payments. Both aspects of the problem – lax underwriting and inadequate consumer protections – were especially acute in loans made by nonbank lenders that were not subject to federal regulation.<sup>4</sup>

In terms of changes to financial consumer protection regulation, legislation should be targeted to the two types of fundamental gaps that fueled the current mortgage crisis. The first gap relates to consumer protection rules themselves, which were written under a patchwork of authorities scattered among different agencies; were in some cases not sufficiently robust or timely; and importantly, were not applied to all financial services providers, bank or nonbank, uniformly. The second gap relates to implementation of consumer protection rules, where there was no effective mechanism or framework to

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<sup>4</sup> Some have suggested that the Community Reinvestment Act (CRA) caused the subprime lending crisis. That is simply not true. As the Administration's Proposal expressly recognizes, and as I have testified before, far fewer problem mortgages were made by institutions subject to CRA – that is, federally regulated depository institutions – than were made by mortgage brokers and originators that were not depository institutions. The Treasury Proposal specifically notes that CRA-covered depository institutions made only 6 percent of recent higher-priced mortgages provided to lower-income borrowers or in areas that are the focus of CRA evaluations. Proposal, *supra*, note 1, at 69-70. Moreover, our experience with the limited portion of subprime loans made by national banks is that they are performing better than non-bank subprime loans. This belies any suggestion that the banking system, and national banks in particular, were any sort of haven for abusive lending practices.

ensure that nonbank financial institutions complied with rules to the same extent as regulated banks. That is, the so-called “shadow banking system” of nonbank firms, such as finance companies and mortgage brokers, provides products comparable to those provided by banks, but is not subject to comparable oversight. This shadow banking system has been widely recognized as central to the most abusive subprime lending that fueled the mortgage crisis.

A new Consumer Financial Protection Agency could be one mechanism to target both the rulewriting gap and the implementation gap. In terms of the rulewriting gap, all existing consumer financial protection authority could be centralized in the CFPA and strengthened as Congress sees fit, and that authority could be applied to all providers of a particular type of financial product with rules that are uniform. In terms of the implementation gap, the CFPA could be focused on supervision and/or enforcement mechanisms that raise consumer protection compliance for nonbank financial providers to a similar level as exists for banks – but without diminishing the existing regime for bank compliance. And in both cases, the CFPA could be structured to recognize legitimate bank safety and soundness concerns that in some cases are inextricably intertwined with consumer protection – as is the case with underwriting standards.

Unfortunately, the Proposal’s CFPA falls short in addressing these two fundamental consumer protection regulatory gaps. Let me address each in turn.

**1. Rulewriting**

**a. Lack of Uniform Rules and National Bank Preemption**

To address the rulewriting gap, the Proposal’s CFPA provides a mechanism for centralized authority and stronger rules that could be applied to all providers of financial

products. But the rules would not be uniform; that is, because the Proposal authorizes states to adopt different rules, there could be fifty different standards that apply to providers of a particular product or service, including national banks.

A core principle of the Proposal is its recognition that consumers benefit from uniform rules.<sup>5</sup> Yet this very principle is expressly undermined by the specific grant of authority to states to adopt different rules; by the repeal of uniform standards for national banks; and by the empowerment of individual states, with their very differing points of view, to enforce federal consumer protection rules – under all federal statutes – in ways that might vary from state to state. In effect, the resulting patchwork of federal-plus-differing-state standards would effectively distort and displace the federal agency’s rulemaking, even though the CFPA’s rule would be the product of an open public comment process and the behavioral research and evaluative functions that the Proposal highlights.

In particular, for the first time in the nearly 150-year history of the national banking system, federally chartered banks would be subject to this multiplicity of state operating standards, because the Proposal sweepingly repeals the ability of national banks to conduct any retail banking business under uniform national standards.

This is a profound change and, in my view, the rejection of a national standards option is unwise and unjustified, especially as it relates to national banks. Given the CFPA’s enhanced authority and mandate to write stronger consumer protection rules, and

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<sup>5</sup> See, e.g., Proposal, *supra* note 1, at 69 (discussing the proposed CFPA, observing that “[f]airness, effective competition, and efficient markets require consistent regulatory treatment for similar products,” and noting that consistent regulation facilitates consumers’ comparison shopping); and at 39 (discussing the history of insurance regulation by the states, which “has led to a lack of uniformity and reduced competition across state and international boundaries, resulting in inefficiency, reduced product innovation, and higher costs to consumers.”).

the thorough and expert processes described as integral to its rulemaking, there should no longer be any issue as to whether sufficiently strong federal consumer protection standards would be in place and applicable to national banks. In this context there is no need to authorize states to adopt different standards for such banks. Likewise, there is no need to authorize states to enforce federal rules against national banks – which would inevitably result in differing state interpretations of federal rules – because federal regulators already have broad enforcement authority over such institutions and the resources to exercise that authority fully.

More fundamentally, we live in an era where the market for financial products and services is often national in scope. Advances in technology, including the Internet and the increased functionality of mobile phones, enable banks to do business with customers in many states. Our population is increasingly mobile, and many people live in one state and work in another – the case for many of us in the Washington, D.C. metropolitan area.

In this context, regressing to a regulatory regime that fails to recognize the way retail financial services are now provided, and the need for an option for a single set of rules for banks with multistate operations and multistate customers, would discard many of the benefits consumers reap from our modern financial product delivery system. The Proposal's balkanized approach could give rise to significant uncertainty about which sets of standards apply to institutions conducting a multistate business, generating major legal and compliance costs, and major impediments to interstate product delivery.

This issue is very real for all banks operating across state lines – not just national banks. Recognizing the importance of preserving uniform interstate standards for all

banks operating in multiple states, Congress expressly provided in the “Riegle-Neal II” Act enacted in 1997 that state banks operating through interstate branches in multiple states should enjoy the same federal preemption and ability to operate with uniform standards as national banks.<sup>6</sup>

Accordingly, repealing the uniform standards option would create fundamental, practical problems for all banks operating across state lines, large or small. For example, there are a number of areas in which complying with different standards set by individual states would require a bank to determine which state’s law governs – the law of the state where a person providing a product or service is located, the law of the home state of the bank employing that person, or the law of the state where the customer is located. It is far from clear how a bank could do this based on objective analysis, and any conflicts could result in penalties and litigation in multiple jurisdictions.

Consider the following practical examples of the potential for multiple state standards:

- Different rules regarding allowable terms and conditions of particular products;
- Different standards for how products may be solicited and sold (including the internal organizational structure of the provider selling the product);
- Different duties and responsibilities for individuals providing a particular financial product;
- Different limitations on how individuals offering particular products and services may be compensated;
- Different standards for counterparty and assignee liability in connection with specified products;
- Different standards for risk retention (“skin in the game”) by parties in a chain of origination and sale;

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<sup>6</sup> 12 U.S.C. § 1831a(j); *see also id.* at 1831d (interest rates; parity for state banks).

- Different disclosure standards;
- Different requirements, or permissible rates of interest, for bank products; and
- Different licensing and product clearance requirements.

Taking permissible interest rates as an example, today the maximum permissible interest rate is derived from the bank's home state. Under the proposal, states could claim that the permissible rate should be the rate of the state in which the customer resides, or the rate of the location where the loan is made, or someplace else. States could also have different rules about the types of charges that constitute "interest" subject to state limits. And states could have different standards for exerting jurisdiction over interest rates, creating the potential for the laws of two or more states to apply to the same transaction. And even if the bank figures all this out for a particular customer, and for all the product relationships it has with the customer, that could all change if the customer moved. Does that mean the customer would have to open a new account to incorporate the new required terms?

Such uncertainties have the real potential to confuse consumers, subject providers to major new potential liabilities, and significantly increase the costs of doing business in ways that will be passed on to consumers. It could also cause product providers to pull back where increased costs erase an already thin profit margin – for example, with "indirect" auto lending across state lines – or where they see unacceptable levels of uncertainty and potential risk.

Moreover, a bank with multistate operations might well decide that the only sensible way to conduct a national business is to operate to the most stringent standard prevailing in its most significant state market. It should not be the case that a decision by



one state legislature about how products should be designed, marketed, or sold should effectively replace a national regulatory standard established by the federal government based on thorough research and an open and nationwide public comment process.

Finally, subjecting national banks to state laws and state enforcement of federal laws is a potentially crippling change to the national bank charter and a rejection of core principles that form the bedrock of the dual banking system. For nearly 150 years, national banks have been subject to a uniform set of federal rules enforced by the OCC, and state banks have been subject to their own states' rules. This dual banking system has worked, as it has allowed an individual state to serve as a "laboratory" for new approaches to an issue – without compelling adoption of a particular approach by all states or as a national standard. That is, the dual banking system is built on individual states experimenting with different kinds of laws, including new consumer protection laws, that apply to state banks in a given state, but not to state banks in all states and not to national banks. Some of these individual state laws have proven to be good ideas, while others have not. When Congress has believed that a particular state's experiment is worthwhile, it has enacted that approach to apply throughout the country, not only to all national banks, but to state banks operating in other states that have not yet adopted such laws. As a result of this system, national banks have always operated under an evolving set of federal rules that are at any one time the same, regardless of the state in which the banks are headquartered, or the number of different states in which they operate. This reliable set of uniform federal rules is a defining characteristic of the national bank charter, helping banks to provide a broader range of financial products and services at lower cost, which in turn can be passed along to the consumer.

The Proposal's CFPA, by needlessly eliminating this defining characteristic, will effectively "de-nationalize" the national charter and undermine the dual banking system. What will be the point of a national charter if all banks must operate in every state as if they were chartered in that state? In such circumstances there would be a strong impetus to convert to a state bank regulated by the Federal Reserve in order to obtain the same regulator for the bank and the holding company, while avoiding any additional cost associated with national bank supervision – and that would further concentrate responsibilities in, and stretch the mission of, the Federal Reserve.

In short, with many consumer financial products now commoditized and marketed nationally, it is difficult to understand the sense of replacing the existing, long-standing option of enhanced and reliable federal standards that are uniform, with a balkanized "system" of differing state standards that may be adopted under processes very different from the public-comment and research-based rulemaking process that the CFPA would employ as a federal agency.

#### **b. Safety and Soundness Implications of CFPA Rulemaking**

The Proposal would vest all consumer protection rulewriting authority in the CFPA, which in turn would not be constrained in any meaningful way by safety and soundness concerns. That presents serious issues because, in critical aspects of bank supervision, such as underwriting standards, consumer protection cannot be separated from safety and soundness. They are both part of comprehensive and effective banking supervision. Despite this integral relationship, the Proposal as drafted would allow the CFPA, in writing rules, to dismiss legitimate safety and soundness concerns raised by a banking supervisor. That is, if a particular CFPA rule conflicts with a safety and

soundness standard, the CFPA's views would always prevail, because the legislation provides no mechanism for striking an appropriate balance between consumer protection and safety and soundness objectives.

For example, the CFPA could require a lender to offer a standardized mortgage that has simple terms, but also has a low down payment to make it more beneficial to consumers. That type of rule could clearly raise safety and soundness concerns, because lower down payments are correlated with increased defaults on loans – yet a safety and soundness supervisor would have no ability to stop such a rule from being issued.

In short, as applied to depository institutions, the CFPA rules need to have meaningful input from banking supervisors – both for safety and soundness purposes and because bank supervisors are intimately familiar with bank operations and can help ensure that rules are crafted to be practical and workable. A workable mechanism needs to be specifically provided to incorporate legitimate operational and safety and soundness concerns of the banking agencies into any final rule that would be applicable to insured depository institutions. Moreover, I do not believe it is sufficient to have only one banking supervisor on the agency's board, as provided under the Proposal; instead, all the banking agencies should be represented, even if that requires expanding the size of the board.

## **2. Implementation: Supervision, Examination, and Enforcement**

Consumer protection rules are implemented through examination, supervision, and/or enforcement. In this context, the Proposal fails to adequately address the implementation gap I have previously described because it fails to carefully and appropriately target the CFPA's examination, supervision, and enforcement jurisdiction

to the literally tens of thousands of non-depository institution financial providers that are either unregulated or very lightly regulated. These are the firms most in need of enhanced consumer protection regulation, and these are the ones that will present the greatest implementation challenges to the CFPA. Yet rather than focus the CFPA's implementation responsibilities on these firms, the Proposal would effectively dilute both the CFPA's and the states' supervisory and enforcement authorities by extending them to already regulated banks. To do this, the Proposal would strip away all consumer compliance examination and supervisory responsibilities – and for all practical purposes enforcement powers as well – from the federal banking agencies and transfer them to the CFPA. And, although the legislation is unclear about the new agency's responsibilities for receiving and responding to consumer complaints, it would either remove or duplicate the process for receiving and responding to complaints by consumers about their banks.

The likely results will be that: (1) nonbank financial providers will not receive the degree of examination, supervision, and enforcement attention required to achieve effective compliance with consumer protection rules; and (2) consumer protection supervision of banks will become less rigorous and less effective.

In relative terms, it will be easy for the CFPA to adopt consumer protection rules that apply to all providers of financial products and services. But it will be far harder to craft a workable supervisory and enforcement regime to achieve effective implementation of those rules. In particular, it will be a daunting challenge to implement rules with respect to the wide variety and huge number of unregulated or lightly regulated providers of financial services over which the new CFPA would have jurisdiction, *i.e.*, mortgage brokers; mortgage originators; payday lenders; money service transmitters; check

cashers; real estate appraisers; title, credit, and mortgage insurance companies; credit reporting agencies; stored value providers; financial data processing, transmission, and storage firms; debt collection firms; investment advisers not subject to SEC regulation; financial advisors; and credit counseling and tax preparation services, among other types of firms. Likewise, it will be daunting to respond to complaints from consumers about these types of firms.

Yet, although the Proposal would give the CFPB broad consumer protection authority over these types of financial product and service providers, it contains no framework or detail for examining them or requiring reports from them – or even knowing who they are. No functions are specified for the CFPB to monitor or examine even the largest of these nonbank firms, much less to supervise and examine them as depository institutions would be when they engaged in the same activities. No provision is even made for registration with the CFPB so that the CFPB could at least know the number and size of firms for which it has supervisory, examination, and enforcement responsibilities. Nor is any means specified for the CFPB to learn this information so that it may equitably assess the costs of its operations – and lacking that, there is a very real concern that assessments will be concentrated on already regulated banks, for which size and operational information is already available.

In short, the CFPB has a full-time job ahead to supervise, examine, and take enforcement actions against nonbank firms in order to effect their compliance with CFPB rules. In contrast, achieving effective compliance with such rules by banks is far more straightforward, since an extensive and effective supervisory and enforcement regime is already in place at the federal banking agencies. It therefore makes compelling sense for

the new CFPA to target its scarce implementation resources on the part of the industry that requires the most attention to raise its level of compliance – the shadow banking system – rather than also try to assume supervisory, examination, and enforcement functions with respect to depository institutions.

Similarly, state consumer protection resources would be best focused on examining and enforcing consumer protection laws with respect to the nonbank financial firms that are unregulated or lightly regulated – and have been the disproportionate source of financial consumer protection problems. If states targeted their scarce resources in this way, and drew on new examination and enforcement resources of the CFPA that were also targeted in this way, the states could help achieve significantly increased compliance with consumer protection laws by nonbank financial firms. Unfortunately, rather than have this focus, the Proposal’s CFPA would stretch the states’ enforcement jurisdiction to federally chartered banks, which are already subject to an extensive examination and enforcement regime at the federal level. We believe this dilution of their resources is unnecessary, and it will only make it more difficult to fill the implementation gap that currently exists in achieving effective compliance of nonbank firms with consumer protection rules.

Finally, I firmly believe that, by transferring all consumer protection examination, supervision, and enforcement functions from the Federal banking agencies to the CFPA, the Proposal would create a supervisory system for banks that would be a less effective approach to consumer protection than the integrated approach to banking supervision that exists today. Safety and soundness is not divorced from consumer protection – they are two aspects of comprehensive bank supervision that are complementary. As evidence of

this, attached to my testimony are summaries of our actual supervisory experience, drawn from supervisory letters and examination conclusion memoranda, which show the real life linkage between safety and soundness and consumer protection supervision. These summaries demonstrate that the results would be worse for consumers and the prudential supervision of these banks if bank examiners were not allowed to address both safety and soundness and consumer protection issues as part of their integrated supervision.

Indeed, we believe that transferring bank examination and supervision authority to the CFPB will not result in more effective supervision of banks – or consumer protection – because the new agency will never have the same presence or knowledge about the institution. Our experience at the OCC has been that effective, integrated safety and soundness and compliance supervision grows from the detailed, core knowledge that our examiners develop and maintain about each bank’s organizational structure, culture, business lines, products, services, customer base, and level of risk; this knowledge and expertise is cultivated through regular on-site examinations and contact with our community banks, and close, day-to-day focus on the activities of larger banks. An agency with a narrower focus, like that envisioned for the CFPB, would be less effective than a supervisor with a comprehensive grasp of the broader banking business.

### **Conclusion**

The OCC appreciates the opportunity to testify on proposed regulatory reform, and we would be pleased to provide additional information as the Committee continues its consideration of this important Proposal.

**Attachment  
to the Statement of John C. Dugan**

**Examples of How Safety and Soundness  
and Consumer Protection Supervision are Linked**

Although the Proposal to create the CFPA is intended to implicate only consumer protection and not safety and soundness, and is premised on a neat division of the two disciplines, supervision of the two areas is inextricably linked. In the OCC model, the two disciplines are interwoven, sometimes performed by the same staff, especially in community banks, and sometimes by integrated teams of specialists. In either case, supervision in one area informs the other in important ways.

The following examples are derived from OCC examiners' supervisory letters and examiner conclusion memoranda and actual examination experience.<sup>7</sup> They demonstrate real-life examples of the interrelationship of safety and soundness and consumer protection supervision in the bank supervision process. This integrated and effective supervisory approach would be dismantled under the Consumer Financial Protection Agency proposal.

***EXAMPLE 1: A safety and soundness examination of mortgage origination practices identified a potentially significant consumer protection issue.***

During a safety-and-soundness examination of the credit scoring models used in mortgage origination at a bank, the OCC's quantitative modeling expert noted that models being developed for future use included variables that raised potential fair lending risks. Because the modeling expert was part of the group within the OCC that provides modeling support for fair lending examinations, the modeling expert was familiar with fair lending law considerations. The OCC expert discussed this issue with the quantitative modelers working for the bank, who articulated technical reasons for the inclusion of the variables, related to building more consistent models. The OCC expert was able to discuss the issues in depth with the bank, helping to identify potential alternatives for use in the scoring model. The bank revised the model under development and potential fair lending issues thus were avoided.

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<sup>7</sup> Supervisory letters typically are provided to bank management at the conclusion of an examination to address exam findings, note violations of law or regulations, or matters requiring attention (MRAs), which are issues that do not necessarily involve violations, but that the OCC requires the bank to nonetheless address. Examiner conclusion memoranda are internal documents prepared at the conclusion of an exam to document examination results.



**EXAMPLE 2: *An examination for fair lending compliance risk resulted in an MRA requiring an enterprise-wide consumer protection (fair lending) risk management program.***

During an examination to evaluate the bank's fair lending compliance risk management program and test compliance with fair lending laws and regulations, examiners found that the bank had not designated fair lending as an enterprise-level risk and did not manage fair lending risk cohesively across the company. Although management maintained an enterprise-level fair lending policy statement, a formal enterprise-level risk management program was not in place. Examiners conveyed the expectation that the bank would have a cohesively stated and implemented mission across all business units, with standard monitoring processes and metrics to measure effectiveness. Examiners required management to submit a detailed action plan to address the issues raised.

**EXAMPLE 3: *A joint safety and soundness and consumer compliance examination of nontraditional mortgage products identified violations related to consumer protection.***

During a joint safety and soundness and consumer compliance examination of nontraditional mortgage products where the primary objective of the review was to assess compliance with OCC Bulletin 2006-41- *Guidance on Nontraditional Mortgage Product Risks*, examiners also evaluated whether nontraditional mortgage disclosures matched the illustrations set forth in OCC Bulletin 2007-28 – *Illustrations of Consumer Information*. Additionally, examiners conducted a concurrent review of stated income products and loans with low or no documentation to determine if the risks involved in these products were sufficiently mitigated. While the exam focused on both safety and soundness and consumer protection issues, the sole violation noted during the exam involved a consumer protection issue. The option ARM payment change notice did not comply with 12 CFR 226.20(c) because it did not include the new interest rate, the prior interest rate and all other rates that applied since the last payment change. The notice also did not include the corresponding index values. It did not indicate if the new payment disclosed any forgone rate increases or if it would fully amortize the loan over the remaining term. As a result of issues identified by examiners, a corrected disclosure form was created and reviewed by examiners during the examination.

**EXAMPLE 4: *A joint safety and soundness and consumer compliance examination of credit cards resulted in an MRA related to consumer protection.***

During a joint safety and soundness and compliance review to assess the adequacy of processes relative to underwriting, account management, collections, and compliance with the credit card Account Management Guidance (OCC Bulletin 2003-1), examiners evaluated credit policies and procedures, controls over a vendor relationship, the quality of MIS, and the bank's marketing plan. Concurrently, examiners also conducted a consumer compliance review that focused on assessing the bank's own testing of controls in place to ensure compliance with the various consumer protection regulations

applicable to credit card lending. While the exam focused on both safety and soundness and consumer protection issues, the sole MRA noted during the exam involved a consumer protection issue. Examiners noted that although the bank had agreed to an action plan for developing appropriate consumer compliance controls, a thorough consumer compliance vendor management program and file testing process had yet to be implemented. Examiners required that the bank develop a comprehensive consumer compliance vendor management program that included file testing for compliance with all applicable consumer protection regulations.

***EXAMPLE 5: Review of a consumer credit unit required an integrated team of safety and soundness, information technology (IT), and consumer compliance examiners.***

During a review of a bank's consumer credit unit, the OCC utilized safety and soundness, IT, and compliance examiners to specifically address the quantity and direction of portfolio credit risk; assess underwriting practices, including compliance with the *Subprime Mortgage Lending* guidance outlined in OCC Bulletin 2007-26; and evaluate collateral valuation methodologies. Examiners also evaluated credit quality assurance reviews, exception tracking systems, and control systems. Other areas assessed in this joint review included model risks associated with the collection and origination scorecards; marketing practices and controls; the adequacy of management information systems (MIS); loss forecasting methodologies, with an emphasis on the ACL process; information technology systems within the bank, with a focus on the consumer credit unit.

***EXAMPLE 6: Review of subprime mortgage products required an integrated team of safety and soundness and consumer compliance examiners.***

During the joint safety and soundness and compliance examination of a bank's subprime mortgage products, the primary objective was to assess the propriety of loan origination and risk management processes. Examiners focused on current underwriting and also reviewed controls established to ensure consumer protection against steering and predatory lending practices. Examiners assessed compliance with banking laws, regulations, and guidance, including recent guidance on subprime products. Examiners tested a sample of subprime loans to assess underwriting and consumer protection processes, reviewed written policies and procedures, and also assessed processes used to measure and monitor subprime mortgage performance.

***EXAMPLE 7: Consumer complaints received by the agency about a third-party service provider triggered a comprehensive review by safety and soundness and consumer compliance examiners of a bank's relationships with that provider***

During a joint safety and soundness and compliance review of a bank's relationships with a third-party service provider, examiners also reviewed other third-party marketing

relationships in existence for the businesses. Examiners reviewed policies and procedures covering due diligence and performance monitoring of third-party marketing relationships. The primary objective was to identify all of the bank's business relationships with this provider and the bank's respective due diligence efforts to monitor and control reputation and compliance/legal risks from these relationships. Products were reviewed to evaluate how they were being marketed, the accuracy and transparency of disclosures to the customer, and whether the products offered value to the consumer. This review was conducted because the third-party provider and its programs were the subject of several recent consumer complaints received by the OCC. It also took into account findings from an earlier credit card UDAP review of marketing, disclosures, and internal controls.

***EXAMPLE 8: A safety and soundness review of a bank's internal audit function found weaknesses in the compliance audit function.***

During an annual review of a bank's internal audit program, safety and soundness examiners focused on evaluating the scope of audit work performed, the effectiveness of following up and validation activities, and the adequacy of management reporting. Test work was completed using the customary integrated approach of having each functional team complete an assessment of audit work in their areas of expertise. The scope of these reviews focused on work paper samples, call program databases, and corrective action databases.

Examiners identified areas for improvement in compliance audit functions. Examiners noted that an overall "state of compliance" for each significant consumer protection regulation would be beneficial to bank executive management in determining compliance risk areas and spending priorities.

The bank's approach to compliance auditing entailed a highly decentralized line of business approach. Examiners noted that related to the lack of an overall compliance roll-up, the compliance audit process would also benefit from improved scoping of higher risk products/services and deeper analysis of activity and associated risks. Because audit testing occurred almost exclusively as part of the line of business audits, examiners noted that few audit resources were dedicated to review specific compliance risks associated with individual products or services.

***EXAMPLE 9: A safety and soundness examination of nontraditional mortgages (NTM) and home equity loans resulted in a series of consumer-protection-related recommendations.***

During a safety and soundness review of a bank's consumer finance unit to assess compliance with regulatory guidances including non-traditional, subprime, and home equity mortgages, examiners assessed the adequacy of risk management oversight and control systems. Examiners specifically targeted underwriting of near-prime broker

originated, interest only mortgage loans, subprime broker originated mortgage loans, and subprime retail mortgage loans. The examiners reviewed risk management MIS, third party monitoring, and mortgage loss mitigation and workout programs. During the review the safety and soundness examiners noted consumer protection issues.

While the combined disclosures provided adequately addressed the requirements indicated in the Statement on Subprime Guidance (OCC Bulletin 2007-26) and in the Interagency NTM guidance, examiners determined that it was based on the proposed, not final illustrations. Additionally, examiners identified that the system which generated the disclosures at the time of application for certain loans was not updated as intended with the combined disclosure.

Examiners made the following consumer protection related recommendations to bank management.

The bank should revise the nontraditional mortgage disclosure, *Consumer Finance Division Comparison of Sample Mortgage Features*, to fully comply with OCC Bulletin 2007-28, provide better consistency with other ARM disclosures, and address computation errors. Additionally, bank management should verify the accuracy of the numbers disclosed in the comparison table. Examiners identified small computational errors in numbers in the table under the interest only 5/1 ARM example and an error in the balloon loan footnote.

Examiners also recommended that quality assurance expand its interest-only mortgage review checklist to verify that the NTM disclosure was provided. Additionally, examiners recommended that the bank verify that all software systems are updated with the most current version of the disclosures when changes occur.

**EXAMPLE 10: *During a trust examination, a number of consumer protection issues were identified.***

During a fiduciary review of a bank's personal trust area, trust examiners identified consumer protection MRAs.

Examiners noted that bank management needed to ensure that trust accounts were properly compensated for income lost as a result of bank errors. Examiners identified one account in a sample where an errant transaction resulted in the nominal loss of interest income. The bank did not reimburse the account for the lost income, as required by internal policy. In addition, there was not a process in place to identify errant transactions and ensure that proper compensation is made to an account. Examiners required bank management to compensate the account noted in the sample and identify tools to be used to ensure that similar situations be detected and resolved appropriately going forward.

Examiners further noted that bank management needed to compensate customer accounts for the loss of earnings from the untimely posting of mutual fund dividends and capital gains. Examiners also noted that management needed to establish or modify policies and procedures to define the remedial measures to be taken in similar situations going forward. The untimely posting of payments negatively impacted the accounts involved and benefited the bank. Examiners required bank management to properly compensate all accounts impacted by the posting problems and ensure appropriate policies and procedures were in place to govern recurrences.