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THE FDIC: CONSUMER ISSUES

Address by

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before the

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The Savings Banks' Association of Connecticut,
~~Cerromar Beach Hotel~~
Dorado Beach, ~~Puerto~~ Rico
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I would like to discuss today a conglomeration of ideas relating to laws and attitudes concerning banks and their customers. Just as the consumer movement relating to banking has grown like Topsy, so has this speech. It has no logical sequence, reaches no major conclusions, and makes no dramatic philosophical statement. Still, in it I hope to address myself to issues which cause as much bitterness and frustration among bankers as any issues now outstanding; to laws whose enforcement is very costly and whose benefits remain unknown; and to questions the answers to which have had or will have dramatic impact on the three-way relationship of the regulator, the banker, and the public.

I

Congress has addressed itself to the relationship between the bank and its customer in several areas. In recent years, this has been most obviously and notably in truth-in-lending, fair credit reporting, real estate settlement procedures, fair credit billing, fair housing lending, equal credit opportunity and home mortgage disclosure.

If nothing else can be said about these laws, it can at least be stated that their enforcement has been controversial.

As we at the FDIC discuss issues with bankers around the country, it is clear that this panoply of consumer laws has caused more irritation and frustration than almost anything else they care to discuss with their regulators. Similarly, as I visit with FDIC bank examiners as I attend our regional meetings around the country, similar frustration is voiced. Congress likewise is unhappy with the enforcement of some of these laws. And the presumed benefits to the consumer have yet to be measured.

The complaint raised by both the regulated and the regulator in some respects is quite similar -- there are too many new laws and regulations and they are too complicated; we can't keep up with them. We want to obey (or enforce) the letter as well as the spirit of the law, but we can't be sure we know what it is.

Many bankers go on to say (particularly those 12,800 bankers who run mutual and commercial banks $50 million or smaller in size) that they are diverted from their main banking responsibilities by this mass of confusing laws and regulations, and that customers of their banks are being charged higher prices on bank services and products because of the added expense of complying with laws, the substance of which they had never violated anyway.

The typical FDIC bank examiner says that enforcement of consumer laws conflicts directly with his primary charge to see that banks operate safely and remain solvent. As he is required to adopt more and more of an adversary position with the banker in the consumer area, especially in light of the examiner's belief that 95 percent of the banks try hard to be law-abiding and fair, and to provide a service to their community, the cooperation he will receive from the banker in conducting traditional safety and soundness examinations of the bank will diminish, costs will escalate, and the accuracy of the examination will suffer.

Examiners could add that their training has been to deal confidentially with banks and supervise them in such a way that they will remain solvent, their problems will remain private, the confidence of the public in the banking system will endure and the public will benefit as a result. They are very thorough by training and find it hard to take shortcuts in analyzing a problem. When faced with the tremendous number of consumer transactions that take place during the course of a year between any bank and its customers, if the proper supervisory posture to be adopted is one of retroactive remedy rather than prospective compliance, examiners will argue that it will be essential to review <u>all</u> consumer transactions so that everyone is treated fairly, a procedure which will be overwhelmingly costly and time-consuming.

The Senate and House Banking Committees are dissatisfied with the enforcement of these consumer laws by the FDIC and the other banking agencies. As a quotation from a recent Committee Report states:

> "The Committee found an unsatisfactory level of enforcement activities by all three agencies."

There is a yearning for simplicity found in the reports of these Committees quite similar to the yearning for simplicity in the irritation expressed by the banks and the frustration expressed by the bank examiners. The Senate Committee, for example, criticizes the Federal Reserve Board for creating regulations "that are lengthy, complex and technical....with the result that both compliance and enforcement are made more difficult." That same Committee also renewed its recommendation that the FDIC, the Comptroller of the Currency and the Federal Reserve Board institute fair housing lending regulations, including a requirement for racial recordkeeping. Actually, last August the FDIC and the Comptroller of the Currency began testing fair housing lending forms and announced at that time that those forms were a necessary prologue to the creation of corrective regulation in the field. The Chairman of the Senate Committee has objected informally to the FDIC that those data collection forms are too complex and lengthy and will frustrate the purposes of the Fair Housing Lending Act. While we disagree and feel the data requested is essential if we are to enforce the Act effectively, we also share this desire for simplicity and believe that our data collection in this area probably can be met by most banks without the use of additional forms beyond what they're already using.

While I certainly agree that a simple law, a simple regulation or a simple form is easier to follow or to complete, the fact remains that to enforce adequately the laws adopted by Congress one needs more than a simple regulation or a simple form. It is the statute, the purpose of the statute, and the complexities of the society in which we live, which lead to the regulations or the forms which create the difficulties in compliance and enforcement. Nevertheless, the yearning for simplicity combined with effective compliance and enforcement exists in the Congressional Committees.

Beyond that, however, there seems to be an implicit belief that the bank regulatory agencies should become consumer advocates, vis-a-vis, the banks those agencies regulate. This may well be the crux of the difficulties that I see in continuing to expect the bank regulatory agencies to adequately enforce the consumer laws.

While this is what we hear from bankers, bank examiners, and Congress, I cannot summarize what consumers have told us since we have no organized way of meeting with consumers. Our Office of Bank Customer Affairs, the unit created in the FDIC in response to recent legislation, has only been staffed for a few months and so far has not generated systematic input from consumers relating to their judgment of the benefits they have received from these many pieces of legislation or to the cost, both direct and indirect, they have paid. While proposed regulations are published for comment, we almost never receive a comment from an individual consumer. On the basis of inquiries received, it appears that consumers are more concerned about insurance coverage and interest rates than about recently enacted consumer protection laws. I expect that over time we will develop improved means of learning of consumer concerns and interests.

II

It is important that you be aware of the framework within which the FDIC operates. The FDIC is a creature of Congress. When Congress passes laws which we are supposed to enforce, we'll enforce them, even if we might have disagreed with the creation of the law. If the appropriate

Congressional Committee disagrees with the way we are enforcing laws, we must and will consider their comments.

While we think our enforcement activities have generally been in accord with our statutory responsibilities, two recent reports by Congressional Committies have been critical of the consumer protection enforcement activities of the bank regulatory agencies. One was issued by the Subcommittee on Consumer Affairs of the Senate Committee on Banking, Housing and Urban Affairs, and the other was a Staff Report of the Subcomcommittee on Consumer Affairs of the House Committee on Banking, Currency and Housing.

The House Subcommittee Staff Report included a survey of approximately 20 percent of the consumers who sent written complaints to the agencies in 1976. We received some good reviews and some bad reviews. The good news is that "the Federal Deposit Insurance Corporation had the highest percentage of consumers who considered the agency's overall complaint handling process to be excellent." The bad news is that only 32 percent of the consumers surveyed called our handling "excellent," and only 27 percent indicated that they were satisfied with our resolution of their problem. While the Subcommittee Staff considers this to be rather poor performance, I am not so sure. Remember, consumers complain to us only after they have tried without success to get their bank to resolve the matter without our intervention. If we were able to effect a solution satisfactory to 27 percent of these unhappy bank customers that does not seem bad to me. In effect, the Staff Report seems to imply that in any dispute between a consumer and a bank, the customer is always right. I don't agree with this, though neither do I agree with the attitude of some bankers that "we never make a mistake, and hence, if there is a disagreement, the customer must be wrong."

The Committee Reports make a number of recommendations, most of which are already in effect or which make a good deal of sense if we accept the view that the FDIC should play a greater role as a consumer advocate with respect to banking problems. The fact remains that there is a strong body of opinion in the Congress that has put a number of consumer laws on the books and would like to see the bank regulatory agencies become more of a consumer advocate than they have been.

I believe it is informative for our agencies as well as the banking industry to list some of the major recommendations made by these Congressional Committees:

1. The FDIC should promulgate regulations on fair housing lending, requiring notations of the race and sex of applicants.

2. We should consider whether compliance examinations should be conducted separately from regular examinations and by separately trained investigators.

3. The FDIC should insist upon affirmative remedies for violations of consumer laws, retroactive as well as prospective.

4. The FDIC should not hesitate to publicize violations of consumer laws.

5. The FDIC should create an "outreach" capability so that consumers will be able to file more easily their complaints with the

FDIC; this would require not only an expansion of the Office of Bank Customer Affairs into the regions but apparently beyond the regional office.

6. The FDIC should educate consumers on their rights, vis-a-vis the banks, by the use of leaflets, posters, toll free telephone numbers, and shopping guides.

7. The FDIC should expand the Office of Bank Customer Affairs so that it will review and resolve all complaints received from consumers within its own unit rather than making use of bank examiners already existing in the Division of Bank Supervision.

8. The FDIC should create and distribute a consumer complaint form.

III

Whatever else may be the case, it is clear that the examination system already in existence gives the banking agencies a much greater ability to enforce consumer legislation in banks than any other existing agencies. The banking agencies periodically examine each and every bank in the United States. No other existing agency that might take over this enforcement responsibility periodically and systematically examines the entities it regulates. For example, the Federal Trade Commission has the responsibility of enforcing truth-in-lending laws with respect to furniture stores, appliance dealers, etc., but the Commission obviously can enforce such laws only as a result of of a complaint. They are not on the premises examining the records of furniture stores or appliance dealers on an annual basis. The Banking agencies, on the other hand, are in the bank every year looking in detail at the loan transactions of the bank. Thus, in the normal course of bank examination, we find some violations of law that would never be found by the Federal Trade Commission if it were the enforcing agency.

To some extent we have been given these responsibilities because we already have an enforcement mechanism in place. But the mere fact that there is an examination force in operation does not mean that using that force to enforce consumer laws is free. All of our examiners are already at work full time. Using an examination approach to enforcing consumer laws requires the creation, in effect, of an additional examination force. We currently estimate that about 10 percent of our supervisory effort is taken up with reviewing compliance with laws and other matters not related to safety and soundness. This amounts to approximately $5 million annually. Said another way, we have added approximately 230 employees to our work force to enforce consumer laws. This is tending to increase as the number of our responsibilities increases and as we seek to do a better job in this area. We need to add, for example, a substantial additional training program, since the regulations are extremely complex and, as I mentioned earlier, I hear complaints from our examiners that they do not understand all the rules and are hard put to find the time to keep up with changes and additions.

Since the area is not a static one, it is difficult to predict just what the cost will be ultimately in enforcing these laws through the examination process. Vigorous enforcement along the lines the Committees have recommended would cost substantially more than the current $5 million -- at least double that amount. It is not up to us to determine whether the benefits justify these costs, that is a matter on which reasonable men may differ. I believe that Congress should and will consider these costs if we present them in an understandable way. We hope to be able to do that during the next Session of Congress. Of course, we have no way of estimating the cost to the consumer because of the additional costs added to the banking system itself but, obviously, the total additional cost to the banking system dwarfs the costs to the FDIC.

An additional factor supporting this role for the banking agencies is the fact that in the past both the banking community and the banking agencies have supported the idea that any kind of legislation affecting banks should be enforced by the banking agencies rather than other governmental agencies. That has been the policy that has led to enforcement of the financial disclosure laws by the banking agencies rather than the SEC and the definition of deceptive banking practices by the Federal Reserve Board rather than the Federal Trade Commission. That view on the part of the banking community in the past was based partly on the view that the banking agencies are more knowledgeable about the real day-to-day problems and operations of banks than other agencies would be. That is still valid today. It may also have been based on the view that the banking agencies would not enforce the laws as vigorously as other Government agencies. I doubt that this was valid in the past, and I certainly do not believe that it is today. It may be time to rethink the general policy that enforcement of a wide variety of laws be enforced, with respect to banks, by the banking supervisory agencies.

IV

In considering whether the FDIC should take a stronger role as a consumer advocate, that is, go beyond what we already are doing, I am troubled by one important consideration: Will our taking a stronger adversary position vis-a-vis the bank with respect to consumer matters adversely affect the performance of our major activity, examination of the safety and soundness of banks? It has frequently been said before that the examination process is a cooperative one between the examiner and the bank rather than an adversary proceeding. If the banks begin to perceive the examiner as an enemy, will that destroy some of the free exchange of information and general cooperation that facilitates an examination? I do not know whether that would be the case, but it is obviously a matter of great concern. I have raised this question in a number of recent meetings with our examiners and supervisors. A very large majority felt that increased enforcement activity on consumer matters would adversely affect their ability to do a good job on safety and soundness examinations. They may be wrong, of course, but their perception of the situation will alter the way the job gets done.

It is possible that this effect differs with respect to the condition of the bank. It may be that with respect to a bank whose condition is poor, and is subject to substantial criticism from the examiner, the relationship is already an adversary one and would not be affected by what we would do in the consumer area. On the other hand, most of our examination time is spent in the overwhelming majority of banks that are in good condition. If in that majority of cases the ability of the examiner to do his job is going to be impeded and examination is going to take significantly longer, then that would be a severe loss to our examination program as well as a substantial increase in cost.

I am concerned about this because I think that our performance in what up to now has been our major responsibility, the supervision of safety and soundness of banks, has been very good. I am reluctant to see changes in that that may upset the quality of that performance in the absence of a clear-cut understanding of what we are doing. I recognize, however, that in some areas within the general area of safety and soundness our relationship with banks is becoming more formal and, in some cases, more of an adversary relationship. We now issue many more cease and desist orders in matters relating to bank safety and soundness. We recently imposed fines on banks that were delinquent in submitting required reports to us. These are evidences of a more arms-length rather than cooperative relationship between supervisor and supervised.

V

It is useful, I believe, to make a comment at this time about the approach of the State of Connecticut and its Banking Department to truth-in-lending, as compared with the approach of the FDIC.

The FDIC handles complaints differently from violations discovered during the course of an examination. With respect to complaints, about 60 percent of which are handled in the Regional Office and the remainder in the Washington Office of Bank Customer Affairs, either the Regional Office or the Office of Bank Customer Affairs attempts to resolve the complaint either by telephone with the affected party and the bank or by authorizing a field investigation by an examiner. If in the judgment of the examiner, the Regional Office, or the Office of Bank Customer Affairs the complainant has had his or her rights violated, the examiner or the Regional Office will tell the bank the conclusion that they have reached and recommend that the bank make restitution or take whatever other affirmative action is necessary to remedy the violation. In nearly all cases, the bank is willing to do that.

If a violation of a consumer law is discovered during the course of a bank examination, however, the efforts of the Corporation are devoted to insuring that the bank will not continue the procedures which result in that violation in the future. In other words, the remedy is prospective rather than retrospective. The customer affected by the violation is not notified by the FDIC and the bank is not urged to take affirmative action with respect to that individual customer. It should be said that only a sample of truth-in-lending transactions is reviewed during the examination, a sample sufficiently large to permit the examiner to judge whether the bank is complying with the law.

The State of Connecticut, on the other hand, has a separate corps of examiners whose only examination responsibility is to examine banks and other financial institutions to insure that they are complying with the Connecticut truth-in-lending law. Rather than reviewing a limited sample, these examiners review nearly every consumer transaction that has taken place in the bank since the last state bank examination. Every violation discovered, even those which in no way are harmful to the customer, is written up and discussed with the banker. As I understand it, the Connecticut examiner and the Department then make a decision on what affirmative action to take with respect to the violation but in many cases require the bank to compensate its customer for damages suffered as a result of the violation.

We are convinced that the Connecticut Banking Department and its compliance examiners do a more thorough job of reviewing the truth-in-lending violations in the State of Connecticut than the FDIC examiners do. Whether the additional cost the State incurs is worth the benefits to the Connecticut consumers we feel is a question for the State of Connecticut to answer, not the FDIC or the Federal Government.

Connecticut is one of five states (the others being Maine, Massachusetts, Oklahoma and Wyoming) which the Federal Reserve, the

Federal agency which has been given the authority by Congress to make such decisions, has exempted from the Federal truth-in-lending laws.

The FDIC has decided that its examiners should no longer examine banks in these five exempt states to see if they are complying with the truth-in-lending laws. It clearly is an unnecessary duplication with the activities already being conducted by the state examiners in those states.

VI

Let me turn to some specific issues and conflicts in dealing with consumer matters. I mentioned earlier that in some cases where we find consumers have been treated unfairly, we have been successful in gaining restitution for the consumer. But our legal basis for this is not completely clear. Under Section 8(b) of the Federal Deposit Insurance Act, the FDIC is empowered to order an insured nonmember bank to cease and desist from any violation of law, "and further, to take affirmative action to correct the conditions resulting from any such violations." While the limits of this authority have not been tested in the consumer protection context, we believe that the authority probably includes the power to order restitution in appropriate cases. What is an appropriate case, of course, will depend on a number of considerations, not the least of which is the particular nature of the consumer's injury and whether restitution is necessary to compensate for that injury. Our existing authority may be sufficient, but we believe it would be preferable to have a specific legislative authorization and mandate to require restitution. Despite comments by Congressional Committees that we should do more in protecting consumers, we have not been given this specific legislative mandate, nor, we must confess, have we specifically sought it.

These considerations rest heavily on interpretations of law and regulation, and are somewhat afield from the area of real expertise of our examiners. I mentioned that over time we could fill this gap with appropriate training of our bank examination force. An alternative approach would be to have a separate consumer compliance staff to handle enforcement in this area and separate compliance examinations. We already have had the experience of separate compliance examinations in three states in which, on an experimental basis and to a limited extent, we are not conducting safety and soundness examinations. While we have dropped the concept of separate examinations, there is strong support among our examiners for a separate staff of specialists. In part that is because they find the work dull; in part because they feel it is a deviation from an examiner's career path; in part it is because they feel the purposes of the two examinations are inevitably in conflict; and in part it is because it is too difficult to stay current with the changing laws and regulations in addition to their other responsibilities. As I mentioned before, if we do develop a separate corps of consumer law examiners conducting separate examinations, there will obviously be a substantial additional cost to the FDIC, the banks, and the general public.

Should we publicize a bank's mishandling of customer transactions? As I have indicated, we have usually been successful in getting banks to agree to change practices that we believe violate existing laws and regulations. We see no purpose to be served by public announcement of past violations we have discovered which have been inadvertent, technical, or have been corrected. If we are unable to gain agreement by the bank to change the offending practice, we can take some formal action under Section 8(b) of the Federal Deposit Insurance Act. It should be said, however, that we have seldom been unable to get the correction made, and so seldom have considered a Section 8 action. Once we initiate such a formal enforcement action, there may be some merit in publicizing that fact, the nature of the charges and the eventual result. Such publicity may well have a legitimate deterrent effect, without generally carrying with it the same potential for mischief present in the case of publicizing formal cease and desist actions involving unsafe or unsound practices.

Nevertheless, it is quite probable that the threat of publicity may aid us in getting the bank to resolve disputes in favor of the customer even if the bank feels it has acted fairly. I have serious reservations about using the threat of unfavorable publicity as a means of coercing a bank to do something it does not believe it is legally required to do. If there are differences concerning the legality or fairness of certain practices, those should be resolved in accord with the judicial process and not by a threat of unfavorable publicity. After all, our judgment is not infallible so why should we be permitted or encouraged to enforce it as though it were.

The idea of greater publicity leads to other problems as well. What if the bank has serious supervisory problems? In that situation the conflict between safety and soundness and enforcement of consumer laws is most obvious.

I do not plan to discuss the merits of the consumer protection legislation that has been enacted. I must stress, however, that the merits deserve attention, review, and analysis. The experience of RESPA is a case in point. There undoubtedly were some abuses in real estate settlement procedures, and some changes in law were probably warranted. The specific action that Congress took, however, was too elaborate, too complex and too cumbersome. When the results of the law became apparent, Congress recognized reality and substantially revised the law, and I think the Congress deserves credit for that. You may feel that the shortcomings of the original law were obvious beforehand; in fact, many real estate lenders pointed out its shortcomings to the relevant Congressional Committees. Obviously, their testimony was not persuasive, perhaps because Congress has heard nothing but opposition to consumer legislation from bankers and no longer pays any attention to it. The experience of RESPA should improve the credibility with Congress of those who responsibly point out burdens in proposed consumer legislation in the future.

Truth-in-lending is another example where the costs of the legislation are being recognized by the Congress. The Senate Banking

Committee has called on the Federal Reserve to propose revisions in the law to simplify the regulations

It is difficult for us to articulate clearly the estimated costs of compliance with consumer protection laws. But it is even more difficult to show the actual benefits to consumers from such legislation. The original objective of the truth-in-lending law was to enable consumers to shop for the lowest source of credit. The law does make that possible, but we do not know whether consumers are taking advantage of that possibility and, hence, whether they are being benefited by the law. A study completed a few years ago concluded that:

> "Consumers who borrowed on installment loans since the truth-in-lending law went into effect are more aware of the true rate of interest that they are paying than were consumers who borrowed before the law was enacted. In spite of this improvement, however, borrowers are still largely unaware of the rate of interest they are paying even though this rate has, by law, been imparted on them. Only one-tenth of borrowers can estimate the rate of interest they are paying on a car loan with a 10 percent margin of error, and nearly half of all borrowers miss the mark by 50 percent or more."

I think an updating of this sort of study is important, as well as a determination of whether consumers are actually shopping for credit. If consumers aren't benefiting from this legislation, then a lot of time and money are being wasted. If they are benefiting, then Congress has a way to measure the value of the legislation and to demonstrate, if that is the case, that these benefits outweigh the costs.

The essential point here is simply that increased consumer protection laws have both benefits and costs. The net effect of every increased piece of consumer protection legislation is not necessarily to the good, nor is the resulting increased regulation of banks necessarily bad. We need more objective calculation and evaluation of these costs and benefits.

It is pretty clear, however, that we are going to have a substantial volume of legislation designed to protect consumers in their dealings with banks and other lenders, and we hope to contribute to a careful analysis of the costs and benefits of such legislation.

These are just a few of the issues raised by the creation of legislation designed to establish standards of performance for banks in this country, vis-a-vis consumers of banking services. The FDIC is in the midst of trying to adapt to the additional role given to it by this legislation. In many respects, this new role conflicts directly with the traditional role and function of the Corporation as a regulator of the safety and soundness of banks. While the costs and benefits are just now becoming apparent, I do not feel that it is the function of the Corporation to judge the merits of the legislation against these costs and benefits, but that it is our function to bring the costs and benefits to the attention of Congress.

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