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FEDERAL DEPOSIT INSURANCE CORPORATION

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Statement on

Truth in Lending Act

Presented to

Commerce, Consumer, and Monetary Affairs Subcommittee
of the
House Committee on Government Operations [, by John J. Early]...
~~House of Representatives~~

by

Federal Deposit Insurance Corporation

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The objectives of the FDIC's examination and supervisory efforts have been and are to promote safe and sound banking conditions and to insure that banking practices are in compliance with applicable laws. Determining compliance with Truth in Lending is an integral part of this total supervisory function.

FDIC field examiners have been checking banks within our enforcement jurisdiction for compliance with the Truth in Lending Act and its implementing Regulation Z since July 1, 1969, when the law became effective. During the first few years of enforcement of that law, discovered violations were reported by means of a separate letter-report to the bank's board of directors. On September 9, 1974, field examiners began using a Truth in Lending Compliance Report form to identify types of violations and to describe a bank's noncompliance with Truth in Lending. Attached is a copy of the form. The form sets out several key questions with respect to compliance with Regulation Z and answers are based upon the results of a selected sampling, upon statements made by bank's management regarding procedures and policies, and upon observations by the examiner. In the case of negative answers, details are provided and management's promised remedial action noted.

Checks for compliance with Truth in Lending are performed during the course of regular commercial examinations except in the states of Georgia, Iowa, and Washington. In those states separate compliance examinations are conducted in selected banks which the FDIC as part of an experimental program

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to test the feasibility of relying on examination reports prepared by state examiners, is not regularly examining for safety and soundness. A review for Truth in Lending compliance involves a sampling of the disclosures made in connection with various types of consumer credit transactions, both open end and closed end, the practices used by the bank in according customers their rights of rescission, the bank's advertising for consumer credit, and its practices in issuing credit cards and orally disclosing annual rates. This review for Truth in Lending compliance has been recently expanded to include the Fair Credit Billing amendments to Regulation Z.

Checking for compliance now involves a judgmental sampling of the pertinent transactions or records. In determining the size and scope of the sample, the examiner considers the composition, volume, and source of the consumer credit portfolios held by the individual bank under examination. If the sample reveals numerous or serious violations, the sample size is increased and a more thorough review is conducted.

The FDIC has been testing the feasibility of using statistical sampling techniques in determining a bank's compliance with Truth in Lending. This program, which has been thoroughly pilot tested, is being put into use in two Regions immediately in order that we will be able to determine how it can be improved operationally. On the basis of current findings we believe an effective statistical sampling procedure can be incorporated into the compliance examination process nationwide.

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Based on the findings of the compliance examination, the examiner meets with bank management to discuss any violations or deficiencies and seeks changes in the bank's procedures to avoid future violations of the type discovered. The completed Truth in Lending - Fair Credit Billing Compliance Report is submitted to the Regional Office for review and follow-up action. In order to obtain compliance with Truth in Lending, Regional Office follow-up activity can include additional correspondence with the bank, conferences with bank management, or a re-examination of the bank. If it appears that compliance cannot be voluntarily obtained, a formal proceeding is instituted under Section 8 of the FDI Act.

The present procedures utilized by the FDIC to obtain compliance with Truth in Lending do not include notification to the bank customers of any deficiencies or violations discovered in their credit transactions with the bank--a matter that is now being reviewed.

Violations of Truth in Lending are also brought to our attention through the complaint or inquiry process. Again, as with violations discovered through the examination process the bank is required to take whatever action is necessary to avoid future infractions. In addition - and as opposed to our present practice where violations are discovered during the examination process - the factual and legal issues involved in the complaint and the availability of any private civil remedies are pointed out to the consumer.

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The FDIC is in the process of reviewing its entire consumer protection role. This review is focusing in particular on the nature of our enforcement responsibilities under the various recently-enacted consumer protection laws, any possible conflicts of interest with traditional safety and soundness responsibilities that may be involved, and the types of remedial enforcement actions authorized and contemplated by these laws. A study group composed of senior staff members from the various divisions and offices within the FDIC is conducting this review. Their policy recommendations to the Board of the FDIC will deal specifically with the issues of public disclosure through the media of individual bank noncompliance with Truth in Lending regulations, notification to borrowers that their loan transactions have involved violations of Truth in Lending and what role, if any, the Corporation should play in rectifying violations and indemnifying borrowers.

The FDIC has taken a number of positive steps to meet its consumer protection responsibilities. First and foremost, of course, is the substantial time and efforts our examiners spend checking individual banks for compliance. In the past year and one-half our examiners devoted over 48,000 man-hours to examining for Truth in Lending compliance.

Our examiners have received considerable instruction in consumer protection requirements and enforcement and our training program in this area is being expanded substantially. The School for Senior Assistant

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Examiners will provide 35 hours of training in federal consumer protection laws, including the preparation of the FDIC Compliance Report. One session will be held in November 1976. Approximately nine sessions will be held in 1977.

In April of 1975, we established an Office of Bank Customer Affairs to receive and act on consumer complaints and represent the consumer's interest and viewpoint on matters coming before our Board of Directors. Since its establishment, this office has processed over 300 complaints and is in the process of adding additional staff to better enable it to discharge its responsibilities.

Over the past several years, we have staffed many of our Regional Offices with Regional Counsel who are able to interpret the frequently complex provisions of consumer protection laws and advise and assist our Regional Office staffs and their respective examiners in discharging their compliance examination and follow-up enforcement responsibilities. In addition, our Regional Counsels have been of assistance to numerous bank customers.

With respect to the comparative results of our compliance examinations in Connecticut versus the results obtained by the state examiners, we believe the State of Connecticut and the FDIC have taken a somewhat different approach in enforcing Connecticut's Truth in Lending law.

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FDIC examiners take a representative sample of the various consumer credit transactions in order to determine compliance with Truth in Lending. If violations are discovered the sample size is increased. In reporting violations, our examiners do not list all the violations which they may find in a bank nor do they indicate any monetary adjustment as a result of these violations. Instead, our examiners list representative examples of the various types of violations discovered.

In order to facilitate follow-up procedures by the Regional Offices, our examiners have been instructed to provide an estimate of the number of consumer extensions of credit in violation as a percentage of the total consumer credit held by the bank, or, in lieu of this percentage, to provide an assessment of the degree of noncompliance by the bank in the area of Truth in Lending. Truth in Lending violations discovered by our examiners are followed-up by the Regional Offices to insure that the banks involved are taking the necessary steps to avoid future Truth in Lending violations. This supervisory approach has been successful in obtaining required corrections in almost all cases. When these efforts are found to be inadequate, the FDIC can require correction through its Section 8 proceedings.

It is our understanding that the Connecticut Banking Department has a separate department of examiners who are trained as specialists in compliance matters and who have no responsibilities for examining for safety and soundness of the institutions they examine. The FDIC conducted separate

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compliance examinations in selected states on an experimental basis in 1974 using the new Compliance Report form. More violations were disclosed. Later when the new form was used in all states, in conjunction with our commercial examinations, a similar increase in discovered violations was noted. It was concluded that the improved results were due to the new form and the special emphasis it gave to this area of our examination responsibilities. The increasing volume and complexity of consumer protection law may indeed require specialization and this is under consideration.

In examining for Truth in Lending compliance, it is apparently the practice of the Connecticut state examiners to list separately all the violations they find regardless of the number of times a particular violation is repeated in different loan transactions. We believe this approach of listing all violations discovered accounts for a significant part of the disparity in reported findings of Truth in Lending violations by the FDIC and the State of Connecticut.

It appears too that some of the violations discovered and listed by the Connecticut examiners represent deficiencies of a very technical nature such as a dollar difference in the finance charge disclosed which does not significantly affect the annual percentage rate. While this represents a very thorough method of examination for Truth in Lending compliance, we believe our examiners have placed more emphasis on determining

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whether a bank is complying with the basic requirements of the Truth in Lending regulations.

The State of Connecticut is one of the five states which has received an exemption by the Federal Reserve Board of Governors from certain requirements of the federal Truth in Lending Act because the requirements of the state law are equal to or exceed the federal law and the provision for enforcement is adequate. In the exempted states, the states are the primary supervisors of the state Truth in Lending laws. Nevertheless, because of the importance of Truth in Lending to consumers, and the interest of the FDIC in banks complying with all laws, the Corporation has continued to examine for Truth in Lending violations and assist these states in this important function. This has been a cooperative effort on our part without any intention to compete or usurp the state's responsibilities.

We believe the results of these hearings will provide us with valuable information and guidance that will assist us in our reappraisal of this important aspect of our overall supervision of Truth in Lending.

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