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TRENDS AND ISSUES IN COMPLIANCE MANAGEMENT

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TRENDS AND ISSUES IN COMPLIANCE MANAGEMENT

I am pleased to have this opportunity to discuss trends and issues in compliance management. This is an important subject, and it receives the continuous and close attention of the FDIC's Board of Directors.

It is essential to understand at the outset where compliance matters fit within the framework of bank supervision. The spate of consumer and civil rights legislation passed during the last decade and the attendant publicity given its enforcement might lead the casual observer to conclude that the safety and soundness of banks is no longer the principal function of the financial regulatory agencies. I can assure you that nothing could be further from the truth. The safety and soundness of our Nation's banking system has been the number one priority of the FDIC since its establishment in 1934, and any major shift from this priority is highly unlikely.

The concern and commitment that we regulators share regarding a safe and sound banking system cannot be overemphasized. Nor can such a system be taken for granted in our society; a constant vigil is required. We are alert, therefore, to actions or inactions that threaten the stability or profitability of the financial community.

In stressing the high priority that we give to safety and soundness factors, however, I do not intend to understate our commitment to fully and effectively discharge our duties under the various consumer and civil rights laws. Congress has assigned these important responsibilities to us, and we will expend every reasonable effort to carry them out.

To assist you in developing an effective and cost-efficient compliance management program, I would like to share with you today some observations on the growth and importance of consumer and civil rights laws, on current issues and problems, and on possible future developments. I will also offer some suggestions to help you handle your compliance responsibilities.

THE GROWTH AND IMPORTANCE OF COMPLIANCE LEGISLATION

The consumer protection movement in this country may have resulted, in large part, from a recognition of the individual's need to cope with living in a highly complex society. At least until after World War II, our lives were fairly simple, with the family as the nucleus around which activity revolved. The typical individual's life cycle included the minimum required education, marriage, children, and a job that the employee held until retirement. Today, that traditional American family of our youth — working father, mother at home, and two children — is becoming less the norm. People are better educated, have a higher standard of living, are more mobile, live longer, have fewer children, and pursue diverse lifestyles. These social changes have been accompanied by a change in our attitudes about the quality of our lives. Our expectations have risen very substantially. Today, over $250 billion in outstanding consumer credit attests to our desire to "buy now and pay later." There are not many products or services offered these days that cannot be purchased on credit, thanks to an innovative financial community.

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This increase in availability and usage of credit has been accompanied by increased governmental involvement, which has taken two distinct forms. First, there has been a sustained effort to provide consumers with meaningful and understandable disclosure of key information concerning business transactions. The Truth-in-Lending Act, the Fair Credit Billing Act, the Consumer Leasing Act, the Fair Credit Reporting Act, and the Real Estate Settlement Procedures Act all to provide disclosures in the lending process. Other Laws have been aimed at eradicating discrimination. Legislation such as the Fair Housing Act and the Equal Credit Opportunity Act protect consumers from having their personal characteristics rather than their creditworthiness influence the lending process.

Much has been written in the past few years about the costs of this protection. Little information has been available regarding the effectiveness of this legislation until recently. The Federal Reserve has just released the results of the 1977 Consumer Credit Survey, an effort co-sponsored by the FDIC and the Comptroller of the Currency. The study found that consumer awareness of annual percentage rates on credit transactions has dramatically improved since shortly before the Truth-in-Lending law was enacted. Not unexpectedly, however, most consumers surveyed showed limited awareness of Truth-in-Lending disclosures beyond the annual percentage rate, finance charge, and monthly payment size. In fact, consumers found the Truth-in-Lending Act disclosures complex and difficult to understand or remember. The consumers surveyed believed that the most unfair feature of the credit-granting process was the dollar limitation on credit; they did not feel that personal characteristics such as race, sex, or marital status were, in practice, important criteria to lenders. Provisions of the Fair Credit Billing Act were not well known, although a number of the consumers surveyed had experienced billing errors. Maybe one surprising result of this survey for regulators was the finding that no consumer surveyed had contacted a Federal regulatory agency with a credit complaint.

On balance the survey results help to substantiate the beneficial effects of much of the recently enacted compliance legislation. They also indicate that in some respects this legislation is not acheiving its intended purpose and may, in fact, be counterproductive. It is important that we recognize that these laws impose substantial costs on the financial community and that these costs are ultimately borne by consumers. This makes it imperative that we continually re-evaluate these laws and search for less costly and more effective ways to achieve our objectives.

CURRENT ISSUES IN COMPLIANCE

The costs and benefits of consumer legislation are only two of the current issues in compliance.The new Truth-in-Lending enforcement guidelines and the Community Reinvestment Act share the limelight as compliance issues of current interest to bankers.

Truth-in-Lending

The growing concern of the financial regulatory agencies regarding the extent of noncompliance with Truth-in-Lending finally culminated in the recent adoption of uniform enforcement guidelines. Truth-in-Lending violations which have resulted in customer overcharges will require reimbursement to the consumer as the principal corrective action. These violations include understatements of the annual percentage rate or the finance charge and nondisclosures or improper disclosures relating to certain nonfinance charges.

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The guidelines present a number of difficult legal and policy issues, and they were the subject of a good deal of debate before being adopted by the five Federal agencies. We recognize the complexity of Truth-in-Lending and the burden that it imposes on banks, particularly the smaller institutions. However, for banks with an insignificant number of technical violations due to mistake or oversight, corrective action under the guidelines should not be cause for concern. On the other hand, where a pattern or practice of noncompliance is demonstrated, corrective action will be necessary and could be costly to the bank concerned.

Community Reinvestment Act

Since all of your banks have just completed Community Reinvestment Act Statements, the CRA is quite germane for discussion today. As you are aware, CRA requires the regulatory agencies to encourage regulated financial institutions to help meet the credit needs of their local communities, including low and moderate income neighborhoods.

The CRA Statement is central to demonstrating your good faith effort to comply with the spirit of CRA. Each bank's senior management and Board of Directors should be actively involved in the CRA effort. CRA requires banks to continually examine their communities and to consider the ways they can most effectively meet their communities' credit needs, consistent with safe and sound banking practice. A good faith effort to make this assessment, which will frequently include new and more effective lines of communication with members of the community, may result in uncovering excellent business opportunities previously overlooked. It would be a mistake for banks to focus too much attention on the technical aspects of CRA or to treat the CRA process as merely an extension of their advertising budget.

This good faith effort on the part of banks to comply with the spirit of CRA must not be undermined by the regulators. We must avoid the temptation to issue numerous interpretive rulings. Such rulings are normally intended for clarification but almost invariably result in excessive complexity. Moreover, we must be decisive in casting unconditional votes for or against applications with CRA implications; approvals conditioned on specific requirements will surely lead us along the path to credit allocation. We must limit ourselves to evaluating each bank's overall record of performance and avoid offering any specific suggestions on what services or programs the institution might implement. Bankers would be well advised not to seek this kind of "benevolent guidance."

LOOKING AHEAD

Looking ahead, I think we will see some near-term developments in the compliance arena. First, Congressional hearings are already underway on Truth-in-Lending simplification. Action on this front is much needed and long overdue. The Consumer Credit Survey which I mentioned earlier confirms that consumers are being overwhelmed by too much information and information that is too complex. Were Truth-in-Lending disclosures limited to the five major credit terms — interest rate, payment size, dollar amount of finance charge, penalties for late payment, and prepayment procedures — the intent of Truth-in-Lending legislation might have a better chance of being achieved. I strongly urge all of you to actively support enactment of this legislation.

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Secondly, there is a concerted effort by both the Congress and the regulatory agencies to weigh more carefully the costs and benefits of bank regulation. In that vein, the regulatory agencies all have established internal task forces to study existing and proposed regulations. The FDIC's task force has four major objectives — to ensure that a clear need for each regulation is established; that alternative approaches have been considered; that burdens on the public are minimized; and that regulations are clearly and understandably written.

Thirdly, there appears to be a growing recognition of the fact that small banks simply cannot cope with the regulatory burden to the same extent as large banks. There are approximately 15,000 banks in this country of which over 11,500 are under $50 million in assets and almost 4,000 are under $10 million. Except for the most basic banking transactions, these banks do not have a sufficient volume of business to justify the development of internal expertise to meet the numerous compliance requirements or to spread the cost of employing external expertise. The smaller institutions should be either exempted from certain disclosure, recordkeeping or reporting requirements or be provided with greatly simplified requirements.There is no question in my mind that excessive and, in some instances, unfair Government regulation poses a serious threat to the community bank.

Finally, I believe that we will see a continuation of the recent trend toward more active enforcement of the consumer and civil rights laws. These proceedings will be more open to the public and will unfortunately, but probably unavoidably, become more adversary. I hope that this will be balanced by more simple regulations, more thorough training of compliance examiners, and more emphasis on educational programs for bankers.

SUGGESTIONS FOR COPING WITH CONSUMER AND CIVIL RIGHTS COMPLIANCE

Now that I have offered a few thoughts on the past, present, and future of consumer and civil rights regulation, I would like to mention a few things that you might consider, depending on the size and complexity of your bank for your compliance management program.

1. Appoint a compliance officer to supervise your compliance management program. I can speak from experience regarding the need for this individual. It was the FDIC's policy until about three years ago to expect our bank examiners to be thoroughly knowledgeable in all aspects of banking laws and practices. The increasing volume and complexity of new legislation, particularly in the consumer protection and civil rights areas, soon convinced us that we were asking the impossible of our staff, so we instituted a specialized examination program. These specialists are available to consult with you regarding your individual compliance management program, and I encourage you to turn to them for assistance.

2. Adopt written, nondiscriminatory loan policies. By defining in writing the types of credit you are willing and able to extend and under what conditions, you will be in a position to justify your accepted and rejected loan applications and minimize customer complaints arising from misunderstandings. Written policies, of course, are only effective if they are understood by lending personnel and are periodically reviewed and updated.

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Because of the changing profile of the American consumer, credit standards that you developed 10 years ago may be costing your bank a great deal of good business. In addition, it is important that you examine your lending criteria carefully to assure yourself that each standard is a business necessity — meaning that there is a manifest relationship to creditworthiness. Policies that have an adverse impact on minorities or women, for example, run the risk of being challenged.

3. Implement written application forms and procedures for accepting and processing loan applications. For your protection, document lending decisions. Model forms have been provided in conjunction with the issuance of both the Fed's Regulation B and Part 338 of the FDIC's Regulations. They are particularly useful for those banks not having the resources to develop their own forms.

4. Provide training for your employees. Any employee having contact with the public should receive some training in the rudiments of the consumer protection and civil rights laws. Those employees who spend the majority of their time in the lending area require more intensive instruction. Follow-up evaluation of that training through review of completed documentation, review of rejected applications, and visual observation will highlight areas where additional instruction may be necessary.

5. Take customer complaints seriously. The number and nature of customer complaints can serve as an audit of the effectiveness of your procedures and training. In any event, it is just plain good business to be responsive to the concerns of your customers.

6. Demonstrate your support of your bank's compliance management program. Acknowledge employee performance and contributions in this area of bank operations. Implement an internal control program to make certain that your bank's objectives in compliance management are being met.

I pretty well covered the waterfront today and, in doing so, probably raised more issues than I resolved. If we have some time, I would like to respond to any questions that you may have.

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