Speech

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Federal Reserve Initiatives to Support Minority-Owned Institutions and Expand Consumer Protection

It is a pleasure to be here today to talk about issues and programs of mutual interest, with a focus on the Federal Reserve's work to strengthen our support of minority-owned depository institutions. The Federal Reserve recognizes the important role that minority-owned banks play in the financial services market through the services they provide to their communities. I have chaired the oversight committee on consumer and community affairs at the Board since March and am especially excited to be involved with a number of new and ongoing initiatives. In particular, this morning I am delighted to announce a new program that formalizes the Federal Reserve's long-standing commitment to minority-owned depository institutions. In addition, I will discuss several ongoing supervisory and regulatory initiatives that aim to improve consumer information and expand consumer protection.

Federal Reserve System's Minority-Owned Institutions (MOI) Program
Nationally, there about 200 minority-owned depository institutions serving a broad range of communities and populations. These banks have long played a unique and important role in our banking system by providing access to credit and financial services in markets that have historically been underserved. The Federal Reserve, which supervises just under twenty of these institutions, is committed to promoting the success of the minority-owned depository institutions we oversee. Supporting these institutions is fundamental to our overall supervisory responsibilities for ensuring a safe, sound, and competitive banking system that also protects consumers. We have consistently provided ongoing assistance, through our regulatory, supervisory, and community development functions, to address the unique challenges and needs of minority-owned banks, while at the same time holding them to the high standards of supervisory performance.

The Federal Reserve has tapped the expertise at the Federal Reserve Bank of Philadelphia to spearhead development of a proactive training and technical assistance program for minority-owned depository institutions. The new minority-owned institutions (MOI) program I will discuss today reflects our experience in addressing the needs of these institutions as well as the insights offered in a recent report issued by the Government Accountability Office.

In developing the program, Federal Reserve staff met with a number of minority-owned and de novo banking organizations across the country, as well as trade groups, bank consultants, and other federal banking agencies, to gain the insight into the challenges the organizations confront in raising capital, growing their institutions, and attracting talent. This process provided valuable insight into the needs of minority-owned banks and contributed significantly to the design of the program. The outreach and market research efforts also informed our understanding of the various issues that de novo and smaller institutions face in general. As a result, some elements of the curriculum may ultimately have broader applicability. Certainly, the components that address broad challenges, coupled with more-targeted training, will address the unique information and technical assistance needs of minority-owned banks. To ensure broad access to the program, all aspects of the training program will be available through a variety of distribution channels: classroom-style workshops, self-paced PC-based programs, and a web-based resource and information center.

The innovative MOI program consists of three modules, each focusing on issues that are most relevant at a particular point in a bank's life cycle: "Starting Up," "Managing Initial Growth," and "Managing a Mature Institution." The program thus will be valuable for potential entrants as well as those that have been in the market for many years. I think of the new MOI program as a type of course of study in a contemporary MBA curriculum, one that draws on insights and experiences from economics, accounting, finance, and compliance and focuses on the particular challenges of establishing and sustaining robust and vibrant minority-owned depository institutions.

The first module, "Starting Up," addresses the steps in filing an application and other issues related to a bank's chartering process, such as raising capital, assembling a successful board and management team, and conducting market analyses. The second module, "Managing Initial Growth," targets institutions that are managing growth and other transitions that occur during the first five years of their existence. Training at this stage focuses on the institution's need to stabilize operations in a competitive environment and addresses issues essential to sustainability, such as maintaining capital and liquidity, managing credit and interest rate risk, ensuring compliance with banking laws and regulations, and developing new products. The third module, "Managing a Mature Institution," focuses on growing the institution and shareholder value. Participants in this portion of the training will learn more about how to achieve growth targets in a safe and sound manner, measure performance of the board and management team, and expand their market.

While these training modules are comprehensive in scope, the course designers recognize that there may be additional information and training needs. A great deal of flexibility is being built into the curriculum, so that an expanded version of the modules can be provided to institutions that have specific concerns or issues. In addition, each module features a section on supervisory and regulatory relations, to help build and maintain a strong dialogue between minority-owned banks and their regulators. The program also provides for quality control and continuing assessment, through such elements as instructor coaching and curriculum evaluation, to ensure that the course remains responsive to the target audiences' needs.

I am also excited about a related benefit of the new MOI program--the possibility of enhancing the Federal Reserve's role as a supervisor of these banks. Concepts underpinning the MOI training program are being incorporated into our examiner education curricula, providing an opportunity for a deeper understanding within the supervision community of the issues unique to minority-owned depositories. This responds directly to the interests expressed by participants in the outreach and market research phase of program development. Many of the bankers indicated that it was important to improve understanding of their business models and strategies among the supervisory agencies, while at the same time holding their minority-owned institutions to the same supervisory standards as other depository institutions.

A pilot program will be launched this fall, with a number of workshops to be held in selected Federal Reserve Districts and a roll-out of some web-based training. Throughout the pilot period and after launch of the full program in early 2008, the Federal Reserve will continue to work with the industry and interagency partners to identify ways to increase the training's responsiveness. This innovative MOI initiative underscores our commitment to providing essential information and supervisory support that helps institutions both improve their operating efficiency--thereby reducing costs and, ultimately, regulatory burden--and enhance their ability to serve their communities more effectively.

Federal Reserve's Functions and Roles in Bank Oversight and Consumer Protection

The Federal Reserve's MOI program demonstrates a long-standing commitment to fostering a banking system that is competitive, diverse, and fair, to the benefit of both banking organizations and consumers. Toward this end, we use all the supervisory, regulatory, and other tools available to us. One example is the recently issued proposal on interagency Community Reinvestment Act (CRA) guidelines, which seeks to affirm that banks' investments in minority-owned banks receive favorable consideration under the investment test. Now I'd like to discuss some of those tools and several recent Federal Reserve initiatives to address current issues of concern, with an emphasis on consumer protection.

The Federal Reserve fulfills its consumer protection mandate through four complementary processes. The first process is examining supervised financial institutions for safety and soundness, and for compliance with consumer protection laws and regulations. This includes taking supervisory action as appropriate to enforce the laws and resolve any consumer complaints. The second is rulewriting--issuing regulations, either separately or jointly with other federal agencies, to implement the consumer financial services and fair lending laws. The third is promoting consumer education through publications and through partnerships with other organizations. And the fourth is promoting community development and fair and impartial access to credit by conducting outreach activities in lower-income communities and traditionally underserved markets.

Supervisory Efforts on Subprime Mortgage Lending

With respect to supervision, the Federal Reserve exercises its examination and enforcement authority to monitor and address issues of concern at the banks it oversees. In addition, we often issue guidance to provide the industry with supervisory "best practices" for addressing safety and soundness and consumer protection matters. Guidance is generally a more-responsive supervisory tool than rules, and it allows institutions more flexibility in adopting new business practices.

Over the years, the Federal Reserve, in concert with other supervisory agencies, has issued a series of supervisory guidance documents to address subprime and nontraditional mortgage lending issues. The guidance has underscored the importance of a well-structured risk-management program for subprime lenders and has stressed that lending standards should include well-defined underwriting parameters, such as acceptable loan-to-value ratios and debt-to-income ratios, and minimum acceptable credit scores. Guidance has also been used to address common predatory and abusive lending practices, including making unaffordable loans, inducing a borrower to refinance a loan repeatedly to generate fee income, and engaging in fraud or deception to conceal the true nature of the loan obligation.

Most recently, supervisory guidance has emphasized the added dimension of risk when higher-risk loans are combined with other features--such as the use of simultaneous second lien loans in lieu of a down payment or the use of underwriting that involves little or no documentation of income or assets. Guidance has also underscored the safety and soundness and consumer protection concerns prompted by other underwriting practices often seen in subprime and nontraditional mortgage lending, such as excluding taxes and insurance in the underwriting process and allowing deferred repayment of principal by offering interest-only loans. Finally, this supervisory tool has been used to urge creditors to work with homeowners who are unable to make mortgage payments.

Reviews of Non-Depository Subprime Mortgage Lenders

This supervisory guidance, together with market forces, has contributed to adjustments in subprime lending practices, particularly by federally supervised banks. However, we are all keenly aware that ongoing issues in the subprime market require additional action to address the very real and significant impact that rising delinquencies and foreclosures are having on individuals and communities.

Various outreach and research efforts by the Federal Reserve have deepened our understanding of the issues and revealed that many of the most-worrisome practices are found in credit extensions by nondepository lenders and brokers, many of which are outside the supervisory scope of the federal banking agencies. The Federal Reserve Board is committed to deterring abusive lending and ensuring that all lenders are complying with consumer protection laws. To that end, the Board has taken the lead in launching a pilot project involving consumer compliance reviews of selected nondepository lenders that have significant subprime mortgage operations. The Board's partners in the project are the Office of Thrift Supervision, the Federal Trade Commission, and the states (through the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators).

As part of this project, the Board will examine nonbank subsidiaries of bank holding companies for compliance with laws that the Federal Reserve enforces. These laws include the Truth in Lending Act, the Equal Credit Opportunity Act, the Home Ownership and Equity Protection Act, the Real Estate Settlement Procedures Act, and the Home Mortgage Disclosure Act. The other partners in the project will conduct similar reviews of nondepository subsidiaries of thrift holding companies, independent mortgage lending companies, and mortgage brokers doing business with these entities. The partner agencies will share information about the examinations, review the lessons learned, and seek additional ways to cooperate to ensure effective and consistent supervision of these entities. At the conclusion of the reviews, the agencies will analyze the results and determine whether the project is to be continued and, if so, what the focus of future reviews will be.

Regulatory Initiatives

In addition to exercising supervisory authority, the Federal Reserve is using its regulatory power to review the Truth in Lending Act (TILA) regulations, with the intent of making the disclosures that help consumers understand their loan terms more effective. To be effective, disclosures must give consumers information about credit pricing at a time when the information is relevant, in language they can easily understand. The information must also be in a format that allows consumers to pick out and use the information that is most important to them. Better credit disclosure facilitates better-informed credit decisions, and hence more-effective competition among creditors. In a nutshell, effective disclosure empowers consumers and enhances competition.

The Federal Reserve Board has recently taken a new approach to increasing the effectiveness of disclosure--namely, surveying and responding to consumers through consumer testing. Having taught at a business school for many years, I am well aware of the types of consumer testing that firms have long employed: surveys, focus groups, and so-called "mall intercepts," whereby shoppers are interviewed at random. Systematically using such techniques to tailor the disclosure requirements set out in the regulations of the Federal Reserve and other financial regulators is, however, relatively novel.

After extensive consumer testing, the Board issued a proposal in May that reflects consumers' thoughts on clearer and easier-to-understand credit card disclosures. In particular, the proposed disclosures would highlight applicable rates and fees, especially penalties that might be imposed. The proposed rules would also require card issuers to provide forty-five days' advance notice of a rate increase or any other change in account terms so that consumers will not be surprised by unexpected charges and will have time to explore alternatives.

Recognizing the value of public input and our experiences in consumer testing, the Board is now engaged in a similar review of the TILA rules for mortgage loans. This process began last summer when the Board convened four public hearings across the country to gather information on the adequacy of current mortgage disclosures, particularly disclosures for nontraditional and adjustable-rate products. As with credit card lending, the Board is committed to conducting extensive consumer testing of proposed mortgage disclosures to identify what information consumers need, use, and retain when embarking on a search for a mortgage. The process of designing and testing disclosures is necessarily time intensive. However, it is a valuable investment, one that will ensure that we have a thorough review resulting in a substantive proposal that presents meaningful new disclosures.

Simultaneously, the Federal Reserve is undertaking other projects that can be implemented more quickly. For example, the Board plans to respond to concerns about misleading or incomplete marketing practices in the mortgage market. By the end of the year, we will propose changes to TILA rules concerning mortgage loan advertisements and solicitations. These proposed rules will also address issues relating to the timing of disclosures, to ensure not only that consumers get the information they need, but that they get it when it would be most useful to them.

The Federal Reserve recognizes that disclosures may not be sufficient to protect consumers from harmful mortgage products or terms. Therefore, the Board plans to exercise its authority under the Home Ownership and Equity Protection Act (HOEPA) to address specific practices that are unfair or deceptive. In June, I chaired a daylong public hearing at which we received valuable insight from both industry and consumer groups into the impact of specific mortgage practices on subprime borrowers. Some of the practices we are looking at are pre-payment penalties, the waiver of escrow accounts for taxes and insurance, and the proliferation of stated-income or low-documentation loans. Concerns have also been expressed about underwriting standards that do not fully take into consideration the borrower's ability to repay. The Board is closely examining these issues and discussing possible remedies. We expect to propose rules under HOEPA later this year.

Community Affairs and Consumer Education Roles
The Federal Reserve also looks beyond its supervisory and regulatory functions to address concerns of information asymmetries and access to financial services in local markets. A core principle of economics is that markets are more competitive, and therefore more efficient, when accurate information is available to both consumers and suppliers.

The Federal Reserve dedicates considerable resources to community development and consumer education efforts designed to help facilitate the flow of accurate information to communities and consumers, particularly those that have been traditionally underserved. The Board, each of the twelve Federal Reserve Banks, and many of the Branch offices have a Community Affairs Office (CAO). These offices work to promote community development and fair and impartial access to credit by focusing on low- and moderate-income consumers. The community affairs function develops programs, partnerships, and initiatives that bring consumers into the financial and economic mainstream and that assist financial institutions in identifying viable opportunities in markets that may be underserved. The CAOs also engage in research to help improve understanding of how financial services policies and practices affect lower-income households and neighborhoods.

In addition, the Federal Reserve has a robust consumer education program. Through our consumer education publications, programs, and partnerships, the Federal Reserve informs consumers about financial transactions and the regulations that govern those transactions, to help them understand consumer protections and their rights when shopping for various products. For example, the Board has published brochures to assist consumers when they are shopping for a credit card, looking for a mortgage, or leasing a vehicle. We have also published brochures to help consumers understand their checking accounts and overdraft protection programs and to educate them on the effects of having their payments processed electronically. Recently the Board has focused on helping consumers better understand nontraditional mortgage products and adjustable-rate mortgages (ARMs) and has prepared a consumer publication on these products. In June, we launched an online mortgage calculator that allows consumers to easily compare their monthly payments, and the amount of equity they will build, under several kinds of fixed- and adjustable-rate mortgages.

In my time at the Federal Reserve, I have had the opportunity to see the benefits that community development and consumer education efforts offer. As noted earlier, I am actively involved with the work of the Board's Division of Consumer and Community Affairs through my chairmanship of the oversight committee. In addition, I am pleased to be serving on the board of *NeighborWorks America®*, a national nonprofit organization dedicated to promoting and preserving affordable housing for low- and moderate-income families and neighborhoods. These roles give me valuable insight into the complexity of the financial services issues in these markets as well as an appreciation of the organizations and institutions that are committed to understanding these challenges and designing creative solutions to overcome them.

Conclusion
In closing, I would like thank you for the opportunity to underscore the Federal Reserve's commitment to promoting the vibrant, competitive, and diverse banking markets that are so vital to our economy. We are dedicated to using our roles as supervisors, regulators, community development facilitators, and consumer educators to support the banking organizations that contribute to our robust financial services system--and the consumers who are vital to that system's success.

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