

Embargoed until
March 20, 2009, at 10:00 am



Statement of

Scott M. Polakoff
Acting Director, Office of Thrift Supervision

regarding

**Federal and State Enforcement of Financial Consumer and
Investor Protection Laws**

before the

**Committee on Financial Services
United States House of Representatives**

March 20, 2009

Office of Thrift Supervision
Department of the Treasury
1700 G Street, N.W.
Washington, DC 20552
202-906-6288

Statement required by 12 U.S.C. 250: The views expressed herein are those of the Office of Thrift Supervision and do not necessarily represent those of the President.

**Testimony on Federal and State Enforcement of Financial Consumer
and Investor Protection Laws
Before the Committee on Financial Services
United States House of Representatives
March 20, 2009**

**Statement of Scott M. Polakoff
Acting Director, Office of Thrift Supervision**

I. Introduction

Good morning, Chairman Frank, Ranking Member Bachus, and Members of the Committee. Thank you for the opportunity to testify today regarding the scope and exercise of OTS's (Office of Thrift Supervision) enforcement authority over the institutions it supervises and regulates and institution-affiliated parties, and, in particular, OTS enforcement of consumer protection laws. My testimony presents an overview of OTS enforcement authority; discusses OTS enforcement policies; provides data showing a steady increase in OTS' formal enforcement actions continuing through the first few months of 2009; and presents examples of OTS formal enforcement actions addressing violations of consumer protection laws.

In addition, my testimony will explain the various ways in which OTS engages in enforcement efforts and initiatives on an interagency basis, making referrals to and coordinating with the Department of Justice (DOJ) and the Department of Housing and

Urban Development (HUD), and working with federal banking and state regulators to address fair lending and mortgage fraud matters.

II. Overview of Enforcement Authority

OTS has authority to take formal enforcement action under the Home Owners Loan Act (HOLA) and the Federal Deposit Insurance Corporation Act (FDIA) against OTS-regulated institutions, including savings associations, their operating subsidiaries and service corporations, and savings and loan holding companies and affiliates. OTS also has authority to take enforcement action against individuals and entities that are “institution-affiliated parties.” This term is defined by the FDIA to include an OTS-regulated institution’s employees, directors and officers, controlling shareholders, agents, consultants and other “persons participating in the conduct of the affairs” of an institution, as well as independent contractors, under certain circumstances.

OTS also has specific authority to enforce compliance by OTS regulated institutions and parties with various federal statutes. In the consumer protection area, for example, OTS examines for and enforces compliance by savings associations with the Truth in Lending Act (TILA) and the Real Estate Settlement Procedure Act (RESPA).

The Federal Trade Commission Act (FTC Act) provides OTS with authority to issue regulations, in addition to other OTS enforcement authority under the FTC Act, to prevent savings associations from engaging in acts or practices that are unfair or deceptive to consumers. The OTS began the interagency effort to protect consumers against unfair and deceptive acts in August 2007 by issuing an Advance Notice of Proposed Rulemaking to seek comments on a broad array of practices related to the marketing, originating and servicing of credit cards and other financial services products. Many commenters responding to the notice urged OTS to take an approach that would lead to uniform and consistent rules that would create a level playing field across the financial services industry.

The Federal Reserve Board and National Credit Union Administration joined the OTS for the next step in the federal rulemaking process and in May 2008, the agencies issued a Proposed Rule that generated 66,000 comments and led to the final rule published in January 2009. The final rule is intended to provide consumers with a reasonable time to pay credit card bills, fairly allocate payments to balances with different interest rates, establish certain restrictions on increasing interest rates, ban double-cycle billing, and limit the fees charged for opening an account. The OTS version of the rule will apply to savings associations, the FRB rule will apply to banks and the NCUA rule will apply to federal credit unions.

The regulation takes effect July 2010 and OTS will have authority to then enforce additional consumer protection regulations. Although the rule is not formally effective until 2010, the agencies have strongly encouraged institutions to implement them as soon as practicable. The OTS has issued a letter to savings association CEOs which asks them to do so. In determining the effective date, the agencies considered the broad scope of the operational changes that the rule will require for information systems and training. They were also mindful of the substantial improvements in disclosure requirements that issuers will have to implement in tandem due to the FRB overhaul of the portions of TILA rules that apply to open end credit. Although most commenters indicated that adapting to these changes would take two years, the agencies required that they be accomplished in about 18 months.

Types of Formal Enforcement Action

OTS's general enforcement power under the FDIA is the same as those of the other federal banking agencies (FBAs). OTS may issue an order to cease and desist (C&D order) to address unsafe or unsound practices, and violations of (i) any law, rule or regulation, (ii) a written agreement entered into with OTS, and (iii) conditions imposed in writing by OTS in connection with the granting of an application or other request by an institution. This includes formal enforcement action to address violations of consumer protection laws and regulations. OTS has authority to initiate formal enforcement actions, such as C&D orders, based on such practices or violations whether they are past,

ongoing, or if OTS has “reasonable cause to believe” that the regulated entity is likely to engage in such practices or violations. C&D orders may be issued by OTS, on consent or after a formal administrative hearing.

OTS may also require affirmative corrective action in C&D orders and other formal enforcement actions. If an association or affiliated party was unjustly enriched, or the violation or practice involved reckless disregard for the law, the formal enforcement action could require restitution or reimbursement by the OTS-regulated entity or affiliated party. OTS has required restitution and reimbursement for violation of consumer protection laws such as TILA and RESPA.

To deter violations of consumer protection and other laws and unsafe and unsound practices, OTS and the other FBAs also may assess civil money penalties (CMPs), on consent or after a formal administrative hearing. There are three statutory “tiers” of CMPs. CMPs can range in amount from \$7,500 to \$1,375,000 per day, per violation depending on the nature and severity of the violation and the amount of loss or unjust enrichment as a result of the violation or practice. OTS takes CMP action for violations of law and regulation, such as of consumer protection laws. In addition, OTS makes referrals to DOJ based on fair lending and other suspected violations.

III. Exercise of Enforcement Authority by OTS

OTS exercises its authority to enforce consumer protection and other laws and regulations, as well as safety and soundness, using the full range of formal and informal enforcement actions. OTS also coordinates with other federal and state banking regulators, functional regulators and DOJ in addressing civil and suspected criminal matters.

OTS examiners conduct compliance, as well as safety and soundness examinations every 12 to 18 months, based on the institution's asset size, condition and previous record of compliance. OTS also evaluates periodic financial condition reports filed by savings associations and conducts off-site monitoring and field visits to follow-up on issues of concern noted at previous on-site examinations. Examiners will evaluate an institution's compliance with applicable laws and regulation. This includes required disclosures and evaluation of the institution's compliance management program as a whole, including adequacy of its policies, procedures and staffing to determine adherence to consumer protection laws, regulations and OTS supervisory guidance. To the extent that noncompliance is found, formal or informal enforcement action is taken in accordance with law, OTS enforcement policy and supervisory considerations and goals.

Significant Considerations in Enforcement Decisions

The number and seriousness of the problems detected, including the extent of actual or potential damage or loss to consumers or the associations are other significant enforcement considerations. In addition, OTS considers whether the consumer violation or other problem was self-identified; whether and when any remedial action was taken by the institution; the ability and cooperation of management to address the problem; and whether the institution is a repeat violator.

In general, enforcement decisions, including those addressing compliance with consumer protection laws, are progressive -- moving from informal to formal action as needed or appropriate based on supervisory and legal evaluations. Consumer protection laws may also specify the type or amount of penalty or other enforcement action. Initiation, modification and termination of OTS enforcement actions, including those that enforce consumer protection laws, are required to be supported by documentation, such as examination findings and transcripts of discussions with management and the board of directors. In some cases, OTS will initiate a formal investigation as authorized by HOLA to obtain additional information, using subpoenas and sworn testimony, before making an enforcement decision. Robust and targeted fair lending examinations involving the review and analysis of underwriting and pricing factors, consideration of consumer complaints, and related factors precede a referral to DOJ or HUD.

Informal Action

OTS may use informal enforcement action when a savings association's overall condition is considered sound, but OTS deems it necessary to obtain certain written commitments from an association or holding company's board of directors or management to ensure correction of identified problems or violations of law or regulation, including consumer protection laws.

Absent unique circumstances, OTS enforcement policy presumes that informal action may be appropriate when an institution is well or adequately capitalized and has an effective compliance program. Examples of informal enforcement action are: an OTS request for board of director resolutions to address specific regulatory concerns or directions conveyed in a supervisory letter or presentation to the board of directors of a Memorandum of Understanding (MOU) requiring corrective action within a specified time frame.

Informal action is nonpublic and is not enforceable in and of itself. The effectiveness of informal action depends in large part on the willingness and ability of the regulated institution or its affiliated party to correct the identified deficiency or violation. If OTS subsequently determines there is noncompliance with informal action by the association or holding company, or finds additional problems, concerns or violations, or

finds that the association's condition has deteriorated, OTS will progress to formal enforcement action.

Formal Enforcement Action

OTS uses formal enforcement action to address violations of consumer protection and other laws, rules and regulations, and unsafe or unsound practices. Formal OTS enforcement actions are made public by OTS. Formal actions include Supervisory Agreements; C & D orders; Removal and Prohibition Orders; and orders that assess CMPs. In practice, nearly all formal enforcement actions taken by OTS are issued and become final on consent. In other words, the regulated institution or party stipulates to the action and waives a formal administrative hearing under the Administrative Procedures Act.

Violations of formal enforcement actions such as Supervisory Agreements and Orders may result in assessment by OTS of CMPs. OTS also may enforce all formal actions except Supervisory Agreements in federal district court.

OTS will use formal enforcement actions when an association has significant problems or violations, has an inadequate Compliance examination rating, or informal enforcement action is deemed inadequate or has been ineffective. In some cases, OTS is

legally required to take certain formal enforcement action, such as pursuant to the Bank Secrecy Act (BSA).

Sometimes OTS takes action jointly with other federal regulators. For example, in 2005, the OTS issued a joint C&D order with a civil money penalty in settlement of charges regarding mortgage settlement practices against Chicago Title Insurance Company. The other parties to the joint settlements were the Office of the Comptroller of the Currency (OCC) and HUD.

Requiring Disclosure, Restitution, Reimbursement and Other Affirmative Action

Formal enforcement action often requires an association or affiliated party to take affirmative action, such as independent audits and restitution or reimbursement and disclosures to customers. In a recent example, OTS entered into a Supervisory Agreement in 2007 with AIG Federal Savings Bank and two affiliates, Wilmington Finance, Inc. and American General Finance, Inc. that resulted from OTS's determination that AIG FSB had failed to manage and control the mortgage lending activities outsourced to an affiliate. Pursuant to this formal enforcement action, objectionable practices were prohibited and AIG FSB was required to establish a \$128 million reserve to cover costs associated with providing affordable loans to borrowers whose creditworthiness was not adequately evaluated and to reimburse borrowers who paid

large broker or lender fees. The three AIG subsidiaries were required to implement a Financial Remediation Plan that included a mechanism for resolving consumer complaints and provided for a clear and accessible audit trail for tracking and verification to address the negative financial impact to certain borrowers from the insufficiently supervised lending activities. In addition the Agreement required the three AIG subsidiaries to donate \$15 million to financial literacy and credit counseling programs.

Similarly, in 2008 OTS issued C& D and CMP orders against Domestic Bank of Cranston, Rhode Island and its subsidiaries to enforce compliance with consumer protection laws (RESPA, the FTC Act, TILA and the Home Owners Protection Act provisions governing private mortgage insurance and OTS regulations governing appraisals and real estate lending). The OTS C&D order required the Bank to prepare and implement a Remediation Plan for the benefit of the Bank's consumers who had been charged large lender or broker fees. In connection with this Plan, the Bank was required to establish a reserve of \$5 million. Bank reimbursement to borrowers was also ordered based on the Bank's violations of the Real Estate Settlement Procedures Act and the Truth in Lending Act and the Bank was required to provide documentary evidence to OTS that such payments had been made. In addition, the order required improvements in the Bank's management and in oversight by the board of directors and the retention of an expert appraiser to prepare a required review and report on appraisals, including those criticized in the OTS examination.

Increase in OTS Formal Enforcement Actions

As the attached chart [See Attachment A] reflects, the overall number of OTS formal enforcement actions has increased significantly since 2006. C & D orders went from 13 in 2006 to 34 in 2008 and total enforcement actions rose from 53 to 68. The OTS Enforcement Division has already litigated one formal administrative hearing in 2009. Moreover, in just the first few months of 2009, OTS issued 15 C&D orders; 11 Civil Money Penalty Orders; four Prohibition Orders; and five PCA directives. Moreover, as of March 2009, the Enforcement Division has filed two Notices of Charges with the Office of Financial Institution Adjudication (OFIA) initiating the formal administrative hearing process.

More specifically, with regard to consumer protection, the OTS has taken the following formal enforcement actions: In 2006, OTS formal actions involving consumer protection issues included two C&D orders, two Supervisory Agreements, and four Civil Money Penalty assessments for violations of laws and regulations that contain flood insurance requirements. In 2007, there were four C&D orders, four Supervisory Agreements and three Civil Money Penalty assessments for flood insurance violations involving consumer protection issues. In 2008, there were six C&D orders, three Supervisory Agreements, five Civil Money Penalty assessments for flood insurance

violations and one Civil Money Penalty Assessment for safety and soundness violations involving consumer protection issues.

Several years ago, OTS began increasing the resources it devoted to enforcement. For example, from 2006 to 2009, OTS nearly doubled the number of its Enforcement Division attorneys from six (three in DC; three in Regions) in 2006 to 10 (six in DC; four in Regions) in 2009. OTS also revised its Enforcement Policies, established model document language to standardize enforcement documents, and is currently engaged in other initiatives to improve and enhance the efficiency and effectiveness of our enforcement process.

IV. Coordination with Other Agencies in Criminal and Civil Enforcement Fair Lending Referrals

OTS also makes referrals of suspected violations and coordinates with other regulators to facilitate other civil actions and criminal prosecutions. In the fair lending area, OTS has increased the number of referrals relating to the Equal Credit Opportunity Act and Fair Housing Act to DOJ (eight since January 1, 2007). OTS has seen a parallel increase in the number of Community Reinvestment Act ratings downgrades due to our findings of evidence of discrimination or other illegal credit practices related to the fair lending concerns. Included within these referrals are five cases based on “steering” consumers to more expensive mortgage products due to their race or national origin.

In 2006, OTS also began to expand staffing devoted to fair lending examination issues (including economists, specialists, experienced examiners and a Managing Director of Compliance and Consumer Protection) to oversee this important area of examination and supervision. OTS also revised and enhanced its fair lending referral process to provide guidance to field examiners and regional offices as they review savings associations with noted fair lending violations that may result in a referral to the DOJ or HUD.

Current, ongoing fair lending initiatives include revisions to OTS Nondiscrimination Examination Procedures and to the OTS' version of the Interagency Fair Lending Examination Procedures, which will be distributed shortly. Updates to the scoping and econometric tools to identify and analyze possible fair lending violations are also in development.

Criminal Prosecution of Consumer Fraud

OTS does not prosecute criminal matters but coordinates with DOJ and the various U.S. Attorneys Offices in the prosecution of criminal cases. OTS is an active participant in interagency working groups and task forces to identify various types of fraud in the financial sector and to determine the civil and criminal options available to hold responsible individuals and entities accountable for their actions. For example, OTS

is a member of the President's Corporate Fraud Task Force, the Bank Fraud Working Group, the Mortgage Fraud Working Group and the newly formed Payments Fraud Working Group.

In addition, law enforcement and the FBAs, including OTS, share relevant information. This provides OTS with a direct mechanism to bring matters it has discovered as likely involving criminal conduct to the attention of criminal enforcement authorities. OTS also supported the efforts of "Operation Malicious Mortgage," a joint collaborative law enforcement effort involving the DOJ, FBI, US Postal Inspection Service, IRS-Criminal Investigation Division, US Immigration and Customs Enforcement, US Secret Service, US Trustee Program, HUD-Office of the Inspector General, VA-Office of the Inspector General and FDIC-Office of the Inspector General. This joint effort resulted in 144 mortgage fraud cases in which 406 defendants were charged between March 1 and June 18, 2008.

OTS also works with federal and state prosecutors to obtain administrative prohibition orders concurrently with criminal convictions against institution-affiliated parties indicted for financial crimes.

In addition, savings associations are required by the BSA and OTS regulations to file Suspicious Activity Reports with Financial Crimes Enforcement Network (FINcen). As

part of our examination process, OTS monitors compliance by savings associations with the Suspicious Activity Report (SAR), and other BSA requirements. OTS uses enforcement actions to correct any failure by a savings association to file SAR and works closely with DOJ and other agencies to improve the handling and management of SARs.

V. Possible Areas for Improving Enforcement Closing the Regulatory Gaps

There are gaps in laws and regulations concerning mortgage lending that leave whole sectors of the financial market unregulated or under-regulated, including mortgage brokers and mortgage companies. Too many players in the housing debt and finance business do not fall under the reach of federal regulations. Therefore, we suggest that Congress consider establishing a level playing field with the same supervision and rules for all players, so the standards of the under-regulated segments of the market are raised to the level followed by the federally regulated segments.

Facilitating Prompt and Effective Regulatory Enforcement

Two other areas in which legislation may improve or facilitate prompt and effective regulatory enforcement of consumer protection and other laws and regulations are 1) expansion and enhancement of federal banking agency injunctive (temporary cease and desist) authority under 12 USC 1818(c) and 2) expansion or clarification of federal

banking jurisdiction over third parties to whom depository institutions have outsourced key reviews, activities or functions.

Under 12 USC 1818(c) OTS and the other FBAs have authority to take temporary and limited, immediate enforcement action for incomplete or inaccurate books and records and when the FBA determines that a violation or unsafe or unsound practice “is likely to cause insolvency or significant dissipation of assets or earnings of the depository institution, or likely to weaken the condition of the depository institution or otherwise prejudice the interests of depositors” prior to completion of a trial-type administrative hearing pursuant to 12 USC 1818(h). The temporary cease and desist order standard does not address the interests of consumers and is difficult to apply in consumer protection and certain situations affecting a depository institution’s safety and soundness.

Clarification of the jurisdictional scope of the term “institution-affiliated party” in 12 USC 1813(u) (3) and (4), in particular with regard to certain third parties, would facilitate enforcement actions against mortgage brokers, appraisers and consultants who violate consumer protection laws and regulations while performing functions outsourced by a depository institution. At a minimum, legislation could add statutory examples of “participation in the conduct of the affairs” of the insured depository institution intended to be included with the definition of “institution affiliated party”.

VI. Closing

Thank you Mr. Chairman. I would be pleased to answer any questions you may have.

ATTACHMENT A

Total numbers of OTS Formal Enforcement Actions (2006-3/2009)

	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u> <u>(01/01 – 03/11)</u>
<u>Supervisory Agreements:</u>	15	7	8	1
<u>Cease and Desist Orders:</u>	13	20	34	15
<u>Civil Money Penalties:</u>	10	5	11	11
<u>Prohibition Orders:</u>	15	13	12	4
<u>Prompt Corrective Action</u> <u>(PCA) Directives:</u>	0	2	3	5
	—	—	—	—
TOTALS:	53	47	68	36