Remarks

By

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Good morning, I am Darrin Benhart, Deputy Comptroller for Supervision Risk Management for the Office of the Comptroller of the Currency. It is my pleasure to be with you, today. I enjoy speaking at events like this because it gives me a chance to get out of Washington to discuss how our policies are affecting the industry. Events like this provide an opportunity for folks on the front lines, like all of you, to come together and discuss the core challenges of the financial services industry—how to identify and manage risk and what to do when some of those credits inevitably go bad. This all sounds simple but we all know how complicated the debt collections world can be today. In the limited time I have with you this morning, I'd like to focus first on two areas of risk we are especially concerned about – auto and home equity lending – and finish with a discussion of our recently issued guidance on consumer debt sales.

By way of introduction for those who are not very familiar with my agency, the OCC charters, regulates, and supervises all national banks and federal thrifts in the United States and supervises the federal branches and agencies of foreign banks. The OCC ensures that the institutions we regulate operate in a safe and sound manner and comply with laws requiring fair treatment of their customers and fair access to credit and financial products. Founded in 1863 by President Lincoln, we recently celebrated our 150th year of service to the country. Today, we supervise more than 1,700 national banks, federal thrifts, and federal branches of foreign banks operating in the United States. National banks and federal thrifts hold about $10.4 trillion in assets. That's more than two thirds of all of the assets in banks in this country. These institutions service about half of all first-lien mortgages and issue 64 percent of the 1.9 billion credit cards in use across the United States. While we supervise the largest banks in the country, where much of the assets and activity are concentrated, about two-thirds of OCC's 2,600 examiners are dedicated to supervising 1,400 federal banks and thrifts each with less than $1 billion in assets.

My role at the OCC is to oversee and lead the agency policy efforts related to commercial and retail credit and to lead the team responsible for identifying and assessing emerging credit and market risk. I also serve as chair for the agency's National Risk Committee, which coordinates the risk identification practices at the OCC. Much of my career with the OCC has been spent as a field examiner, specializing in the review of retail credit products, so I have an appreciation for the complexity of managing an efficient, effective collections operation.

I'd like to start today with a discussion of the OCC's *Semiannual Risk Perspective*.[1] We produce this report twice a year in an effort to inform the industry about emerging risks. The most recent edition of this report was published in June, and we are busily working on the next issue, which we plan to publish by the end of the year. While the June report covers a number of risks, I'll focus on just two—auto and home equity lending.

Auto lending, as pointed out in the report, is a bit of a two-edged sword. Product structures, loan-to-values, and pricing practices raise both credit quality and consumer compliance concerns. Increased wealth and improving economic conditions have improved consumers' confidence and drawn them back to auto showrooms and car lots. The result is a double-digit growth in this product at many of our banks. That healthy growth reflects the consumer appetite for new, or "new-to-you" cars that families may have decided not to purchase in previous years when unemployment was higher and the overall economy more sluggish.

[1] See http://www.occ.gov/publications/publications-by-type/other-publications-reports/index-semiannual-risk-perspective.html.

Total outstanding auto loans in national banks and federal thrifts grew 13 percent in 2013 and have grown by another 4.8% percent through June 30th of this year. Some individual banks that concentrate in this business had growth rates significantly above this level. While that is strong growth, the market remains fragmented with banks, credit unions, finance companies and captives all playing major roles. Banks hold about 29 percent of the total auto lending market, which equates to about $262 billion in outstanding loans.

Competition is one of the factors behind the increased risk we are seeing. Competitive pressure is driving some auto lenders to pursue growth by lengthening terms, increasing advance rates, and originating loans to borrowers with lower credit scores. The marketing of these loans is focusing more on monthly payment, with little attention to the overall debt of the borrower. Average loan-to-value, or LTV rates for both new and used vehicles are getting more liberal and exceeded 100 percent for all major lender categories at the end of 2013. These high LTVs reflect both rising car prices and a greater bundling of add-on products such as extended warranties, credit life insurance, and aftermarket accessories into the financing. The results have yet to show large-scale deterioration at the portfolio level, but we are definitely seeing the signs of increasing risk.

The most obvious indicator of increasing risk is that the average loss per vehicle has risen significantly over the past 24 months. Increased average loss is one indication of how longer terms and higher LTVs can increase exposure. Notably we are seeing average charge-offs in auto lending rise across all lender types over the last year—banks, credit unions, and non-depository finance companies. Among banks, the average charge off for a bad auto loan has increased from $6,832 in the fourth quarter of 2012 to $7,618 in the fourth quarter of 2013.[2] That's a 12 percent increase in 12 months.

[2] Experian, *State of Automotive Finance Market*, 4Q2013.

Some in the media and industry have downplayed the significance of the risk we are identifying in the auto lending industry, but at the OCC, we will continue to monitor product terms and risk layering practices to ensure that banks manage growth and exposure prudently.

Next, I'd like to talk about an area where we have seen a very positive response by the industry with regard to Home Equity Lending, or HELOCs. The risks associated with HELOCS were baked into the system before the last crisis, as people accessed the equity in their homes for a variety of purposes. Between 2004 and 2008, a significant volume of HELOCs was originated, many with a 10-year interest-only draw period. As that draw period ends, some consumers will see significant increases in their payments as the debt is amortized over the remaining years of the loan. Will they be able to cope with this added expense? Will market standards allow them to refinance if necessary? Or, will banks see increased delinquencies related to HELOC?

Those were questions we did not have answers for in 2012 when we started our efforts to raise awareness regarding the risk of the large number of HELOCs reaching "end of draw." Fortunately, we have seen banks and thrifts take prudent action. In December 2011, the volume of HELOCs that would reach their end-of-draw period between 2014 and 2017 exceeded $214 billion. By December of 2013, banks and thrifts had reduced that exposure to $171 billion over the same period.[3] While some of the declining volume reflects normal attrition, it also shows the results of early recognition and active risk management efforts. Many of you in this room likely have worked with borrowers to provide solutions that allow borrowers to get on a stable path to repayment. The OCC applauds these efforts, but recognizes that substantial challenges remain. That's why in June of this year, the federal banking agencies issued guidance clarifying expectations for how banks and thrifts should manage these risks and work with borrowers who may have difficulty either meeting the higher payments that result from principal

[3] See page 32, *Semiannual Risk Perspective*, Spring 2014.

amortization or interest rate reset, or renewing the existing loans because of changes in their financial circumstances or declines in property values.[4]

The guidance articulates five risk management principles worth repeating because their applicability extends beyond HELOCs and reflects sound financial management thinking:

- First, lenders should apply prudent underwriting and loss mitigation strategies whenever they consider modifying existing loans. Prior to extending draw periods, modifying notes, and establishing amortization terms, lenders should evaluate borrowers' willingness and ability to repay the loan.
- Second, management's criteria for HELOC underwriting and credit analysis should be consistent with regulatory guidance for prudent real estate lending. Lenders' underwriting criteria should include debt service capacity and creditworthiness standards, equity and collateral requirements, maximum loan amounts, maturities, and amortization terms. Lenders should establish procedures for reviewing and approving policy exceptions and for reporting portfolio performance.
- Third, where feasible, lenders should provide sustainable workout and modification programs, consistent with the nature of the borrower's hardship, that promote orderly, systematic repayment of debt.
- Fourth, lenders should review end-of-draw modifications for appropriate identification of trouble debt restructurings to ensure they are accounting, reporting, and disclosing troubled debt restructurings, or TDRs properly. TDR treatment is appropriate when a lender grants concessions to borrowers that it would not otherwise consider because of the borrower's financial difficulties.
- Fifth and finally, lenders should ensure appropriate segmentation and analysis of end-of-draw exposure in allowance for loan and lease losses (ALLL) estimation. Before significant HELOC

[4] See http://www.occ.gov/news-issuances/bulletins/2014/bulletin-2014-29.html.

volumes reach their end-of-draw periods, management should be capturing information and preparing analyses that clarify the nature and magnitude of exposures.

Early recognition and sound risk management practices can help lenders avoid loss and reduce exposure, as we have seen with HELOCs, but unfortunately some portion of debt will go into the collections process. The collection process is an important and inherent part of providing credit. The Uniform Retail Classification and Account Management Policy guidelines generally require banks to charge off consumer debt when the debt is 180 days past due. In some instances, the guidelines require banks to charge off debt earlier than 180 days. As folks in this room know, charging the debt off is an accounting requirement. In most cases, it does not extinguish the consumer's obligation to repay the debt. That's why uncollected bad debt retains value that banks can pursue in one of several ways -- by handling the collections internally, by using third parties as agents to collect the debt, or by selling the debt to debt buyers and collectors. Most of the debt that banks charge off and sell involves credit card accounts, but banks also may sell auto, home-equity, mortgage, and private student loans that go bad.

The OCC recognizes banks can benefit from debt-sale arrangements by turning nonperforming assets into immediate cash proceeds and reducing the use of internal resources to collect delinquent accounts. We also understand the responsibility that banks have to their shareholders to recover losses. But, selling debt to debt buyers can increase a bank's operational, reputation, compliance, and strategic risks. These risks generally arise from poor planning and oversight on the bank's part and from inferior performance or service on the part of the debt buyer. As a result, both bank and debt buyer may see increased compliance issues that can result in higher legal costs, enforcement actions, and potentially, loss of business.

In 2011, the OCC conducted a review of debt collection and sales activities across the largest banks we regulate. OCC examiners identified a number of best practices that these banks were using to manage their debt sales activities. In July of 2013, we summarized these best practices and made that summary available to examiners and the industry. Those best practices were further enlightened by comments and input that we received from a wide variety of interested parties, including financial institutions, debt buyers and collectors, consumer and community advocates, and other governmental entities. All of that information was considered as we developed the OCC's Consumer Debt Sales Guidance, which was issued in August.[5]

The guidance describes our expectations for banks that engage in debt-sale arrangements in a number of areas. We expect banks to develop and implement appropriate internal policies and procedures to govern debt-sale arrangements consistently across the bank. We expect banks to perform appropriate due diligence when selecting debt buyers and to ensure debt-sale arrangements (your contracts) with debt buyers cover all important considerations. We expect banks to provide accurate and comprehensive information regarding each debt sold, at the time of sale, and to oversee the debt-sale arrangement appropriately. Finally, we expect banks to ensure that they comply with applicable consumer protection laws and regulations in selling their debt.

That sounds like good common sense and easy enough to do. We recognize, however, that for some banks this is much more difficult in practice than it is in theory. Difficulty, however, does not diminish responsibility or importance. In their work, OCC examiners will determine whether bank management has established controls and implemented a rigorous analytical process to identify, measure, monitor, and manage the risks associated with debt sales. If examiners find unsafe or unsound practices or practices that fail to comply with applicable laws or regulations, the OCC will take appropriate supervisory action, including enforcement actions, when warranted.

Banks need to allocate appropriate resources to ensure information used in collection activities and provided to debt buyers is accurate. Debt sales activities are analogous to debt collection activities. The processes that underlie debt collection often are the same, or very similar to, the processes involved

[5] See http://www.occ.gov/news-issuances/bulletins/2014/bulletin-2014-37.html.

in debt sales. In addition, in order to do it well, both activities require the underlying documentation be comprehensive, accurate, and up-to-date. That only is possible when the bank manages these activities appropriately, including using ongoing quality assurance to uncover deficiencies, and then fixes any shortcomings that are identified in a timely manner. As I just mentioned, when a bank fails to carry out its collection activities, or its debt sales, in a safe and sound manner, or violates the law, or treats customers unfairly, the OCC will take whatever action is appropriate under the circumstances. As an example, just over a year ago the OCC took a public enforcement action against JPMorgan Chase, or JPMC, for a number of unsafe or unsound practices, including deficiencies that our examiners identified in connection with the bank's non-home-loan debt collection litigation practices.[6] In the investigation leading up to the enforcement action, examiners found that unsafe and unsound practices in JPMC's credit card services, auto lending, and student lending business had produced inaccurate court filings. JPMC employees or employees of third-party service providers acting on behalf of the bank executed affidavits without the requisite personal knowledge, and improperly notarized certain documents. Are those concerns starting to sound familiar?

Based on those findings, the OCC issued a cease and desist order against JPMC. Among other provisions, the order required the bank to remediate thousands of harmed consumers. It also directed the bank to improve its policies and procedures to ensure that affidavits and other sworn documents used in collections litigation involving non-home loans are accurate, are based on the personal knowledge of the bank employee signing the documents, and are notarized in accordance with all applicable legal requirements.

That's just one example of the issues we have identified, but as I mentioned earlier, the OCC only regulates some of the players involved with debt sales and debt collections. We issued the Debt Sales Guidance to promote safe and sound collection activities across the industry. We also are coordinating closely with other regulatory and law enforcement agencies. When the OCC becomes aware of concerns

[6] See http://www.occ.gov/static/enforcement-actions/ea2013-138.pdf.

with nonbank debt buyers, we refer those issues to the Consumer Financial Protection Bureau, which has jurisdiction over these entities.

Finally, I'd like to address a point made in the Debt Sales Guidance that we have gotten several questions about. The guidance indicates that certain types of debt are not appropriate for sale because they likely fail to meet the basic requirements to be an ongoing legal obligation of the borrower. The guidance offers a couple of examples of the debt that we had in mind, including "debt of borrowers that have sought or are seeking bankruptcy protection."

The intent of that statement was to protect borrowers during a vulnerable period when creditors become aware that they are likely going to file, or in fact have filed, for bankruptcy protection and are awaiting plan confirmation. We are aware of instances where banks sold accounts to debt buyers after the borrowers had sought bankruptcy protection, and, when those debt buyers continued collection efforts, they violated the automatic stay. The OCC recognizes that in Chapter13 bankruptcies, where the borrower's payment plan has been confirmed, the bank may have the ability to sell the obligation that is owed to it by the borrower. The OCC recognizes, and this reference was not meant to affect cases where certain debts remain valid, such as in a Chapter 13 bankruptcy where the court has confirmed a payment plan. Bank management has the ability to continue to collect and sell the legal debt.

I have covered a lot of ground this morning, and I want to leave time for questions. But I should stress that national banks and federal savings associations do not have to wait for events like the ones I've described to discuss their concerns and questions about any of these issues. Those of you from large and midsize banks have dedicated teams of examiners who can answer your questions. Likewise, bankers at community banks and thrifts have assigned portfolio managers and local Assistant Deputy Comptrollers who are familiar with your particular institution and can discuss issues directly related to your business. If these experienced examiners can't answer your questions, they can quickly reach out to our agency's national network of experts to find someone who can.

We are also in the process of updating all our handbooks at the OCC. We have issued an updated version of our mortgage servicing handbook, and others will follow on credit card lending, residential lending and installment lending just to name a few. Each of these handbooks provide guidance to our examiners on their review of the debt collection process. The guidance documents, handbooks and interaction with our staff provide you with clear direction and transparency regarding our expectations. Such open communication is one key to our effectiveness as supervisors, and we hope you take advantage of these valuable resources.

Thank you again for inviting the OCC to participate in your conference, and I look forward to your questions.