Inner City Press
Community on the Move
&
Fair Finance Watch

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Attention: Docket No. 03-14

Ms. Jennifer J. Johnson, Secretary
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Attention: Docket No. R-1154

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Attention: Comments, FDIC

Ladies and Gentlemen:

On behalf of Inner City Press / Community on the Move ("ICP") and the Fair Finance Watch (the "FFW"), this is a timely comment in response to the Advanced Notice of Proposed Rulemaking on the proposed Risk-Based Capital Rules, published on August 4, 2003, as well as about the Basel Committee on Banking Supervision's ("BCBS's") third Consultative Document on its proposed new Capital Accord ("Basel II")

While most of the comments your agencies receives may be from financial institutions, and those from community organizations may focus on urging you to exclude Community Reinvestment Act investments from the materiality test calculation (a request in which we join), this submission goes further afield, as did FFW's comments to the BCBS itself, dated May 31, 2001, and July 30, 2003 (*see*, www.bis.org/bcbs/cp3/inncitpre.pdf), to touch on matters at the cusp of consumer

protection and safety-and-soundness, with a particular focus on the need to consider and address the explosion in high-rate so-called "subprime" consumer finance lending, including the large internationally-active banks at which Basel II is most directly aimed. Certain of these institutions -- including for example the U.S.-headquartered Citigroup, GE and Wells Fargo, and U.K.-based (but U.S.-active) HSBC and RBS, etc. -- are exporting controversial subprime lending into countries whose regulators explicitly turn a blind eye to these lines of business. It is imperative that the U.S. regulators to which this timely comment is directed accept their responsibility to address predatory lending issues that arise in connection with subprime lenders' activities, both within and outside of the United States. An example given below compares Sweden's explicit refusal to consider lending in its own jurisdiction, and referral of such issues to the "home country supervisor," while U.S. regulators the Federal Reserve, the OCC, OTS and FDIC, and Canada's OSFI, essentially refuse to consider overseas actions by "their" banks. Such inconsistencies bode badly for Basel II, for consumers and, not least, for the global economy. They should be acted on, by your agencies, in connection with Basel II and otherwise.

Discussion: that subprime consumer lending is relevant to, and would be affected by, Basel II was touched on in recent testimony to Congress by James Gilleran, the Director of the Office of Thrift Supervision. *See,* OTS Testimony of June 18, 2003, to the U.S. Senate Banking, Household and Urban Affairs Committee, that an "aspect of this issue that we must consider is the extent to which we alter our existing capital rules, applicable to all banks, to accommodate changes proposed by Basel II. For example, under Basel I, the blunt-edged risk-based capital requirement for 1-4 family residential mortgages (a 50 percent risk-weight, or 4 percent capital requirement) is not commensurate with the historical risk associated with residential mortgage lending in the United States. For residential mortgage loans with relatively low loan-to-value ratios, a substantially lower riskweight is more reflective of loss experience. By contrast, the federal banking agencies have concluded that for some concentrations of subprime loans, a significantly higher risk weight than 100 percent--and therefore, a capital requirement higher than 8 percent--might be more appropriate. While Basel II is intended to enhance the risk sensitivity of our capital rules, it is important that the proposed changes are truly

reflective of actual risk, as measured over an appropriate historical timeframe." (*See also*, Consultative Document at 11, n.19, "Supervisors may determine that higher risk weights for retail exposures are warranted," etc.).

ICP contends that abusive subprime lending implicates an institution's reputational risk, which should be made an explicit part of Basel II's consideration of operational risk, or be separately considered. The above-quoted OTS Testimony continues on to predict that Basel II would directly affect only the ten largest U.S.-based banks. As set forth below, many of these banks (and their counterparts in other countries) are increasingly engaged in subprime lending, on a global basis.

The world's largest bank, by assets and market capitalization, is Citigroup -- which, in acquiring Associates First Capital Corporation in 2000, became a major subprime lender both in the United States and internationally. According to the Financial Times, "[t]he other principal attraction for Citigroup is Associates' strong presence in Japan, where it can now go head to head with US competitors such as GE Capital." *See*, "Associates Attracts Mixed Reception," Financial Times, September 7, 2000, Pg. 31.

Citigroup and its predecessors were engaged in controversial subprime lending well before the acquisition of Associates in 2000. The upper echelon of management at Citigroup -- Sandy Weill, new CEO Charles Prince, Bob Willumstad, Marge Magner, *et al.* -- were all active with the Baltimore-based subprime lender Commercial Credit, which was challenged to the OTS for predatory lending in 1997 when it applied to acquire additional subprime business from Bank of America, and for a federal savings bank charter. We recite these protests to emphasize that standardless involvement in subprime lending carries with it regulatory risk, reputational risk, and, we'll argue, operational risk (*see below*). After the 1998 merger with Citicorp, Commercial Credit was renamed CitiFinancial; by early 2001, it was reported that "Citigroup, the world's largest financial services provider, began its Indian operations with the launch of CitiFinancial Retail Services India Limited. To begin with CitiFinancial will offer easy financing schemes, at retail outlets for the purchase of consumer durable, PC and two wheelers" (*See*, India Business Insight. "Citigroup Unveils Easy Buy Scheme," January 29, 2001).

Soon after buying Banamex, the second-largest bank in Mexico, Citigroup formed what it called a "Consumer Products Unit For Emerging Markets," saying that " the new unit would accelerate the expansion of non-banking consumer financial services into the emerging markets" (Citigroup press release on Business Wire, May 29, 2002). This press release indicated how and where CitiFinancial was going, by contrasting that "Citibank has consumer-banking operations in 36 of its 80 emerging market countries" with the fact that "[i]n the Emerging Markets Citigroup today has consumer finance businesses in 8 countries with assets of $2.5 billion."

Charging interest rates up to 40%, CitiFinancial in early 2003 opened nine offices in Brazil, projecting that it would open 100 more branches over the next five years (Latin Trade, "Branching Out," July 2003). Regarding this expansion, CitiFinancial Mortgage senior vice president L. Ramesh has been quoted that "[i]n several markets, we are the first ones to give them consumer credit... [We ask:]'Where do you live? What kind of stuff do you have?'" (Bank Systems & Technology. "CitiFinancial Adopts Lending Model to Emerging Markets," April 21, 2003).

Inquiring into "what kind of stuff do you have" is reminiscent of CitiFinancial's inquiries with its U.S. personal loan customers, in order to sell them credit insurance they may not need. ICP / FFW documented this practice to the U.S. Federal Reserve Board, asked then-Citigroup CEO Sandy Weill about it at the company's April 2002 annual meeting; the Wall Street Journal finally got and reported Citigroup's answer:

> When it makes a personal loan, CitiFinancial often asks the holders of personal loans to provide collateral. In some cases, according to CitiFinancial documents filed by Inner City Press, that collateral includes fishing lures and tackle boxes, record albums, tents, sleeping bags and lanterns -- items that CitiFinancial would almost certainly never bother to collect in the event of a borrower's default. Yet insurance is sold on the collateral in case it is damaged or lost.
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> "It's predatory: This insurance product has no rationale, because it's not credible that someone would want to have their loan paid with their leaf-blower," said [the] executive director of the Fair Finance Watch project at Inner City Press. "Citigroup has not lived up to the subprime lending reforms it announced after acquiring Associates."
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> Citigroup officials concede seizing such collateral would be more hassle than it's worth. But they say providing such collateral on loans has a purpose -- "to make

> the borrower more responsible for paying the loan back," says Ajay Banga, Citigroup's business head of consumer lending. (Paul Beckett, "Efforts by Citigroup to Reform Subprime Unit Raise Questions," Wall Street Journal, July 19, 2002).

Here, Citigroup acknowledged that while it asked its customers "what kind of stuff do you have?" in order to list the items as collateral and sell insurance on them, it has no intention of foreclosing on the collateral. In fact, ICP has been informed by current and former CitiFinancial employees that the property lists are compiled in order to sell insurance ("Fed Going Extra Mile In Probe of CitiFinancial," American Banker, October 11, 2002, Pg. 1).

Since being permitted by the FRB to acquire European American Bank and Banamex, by the FRB and OTS to acquire Golden State Bancorp, and most recently by the OCC to acquire Sears' credit card and financial services business, CitiFinancial has opened in South Korea, charging interest rates of thirty percent. "Although these rates are higher than the annual 24 percent charged by credit card companies for similar cash advances, CitiFinancial has an edge in that their loans are cheaper than those extended by existing loan sharks... Another reason that people are drawn to the company is because of the renowned brand of its parent group, Citigroup. Customers thus tend to think the company will refrain from excessively aggressive collecting methods" (Korea Herald, July 30, 2002).

The trust that Citigroup would eschew excessively aggressive collection practices, particularly overseas, would be misplaced. last would be wrong. The Asian Wall Street Journal of May 25, 1999 for example, "Paid Back: Citibank in India Has Hired Collectors Said to Use Threats," has reported on a Citibank loan in India being collected on with no less than a knife to the throat. This issue was raised to the U.S. Federal Reserve Board, when Citigroup in 2001 applied for regulatory approval to acquire European American Bank (EAB) and Banamex. The Fed's reaction, in its approval orders, was that "claims about lending activities in India... are either outside the jurisdiction of the Board" or "contain no allegations of illegality or action that would affect the safety and soundness of the institutions involved in the proposal, and are outside the limited statutory factors that the Board is authorized to consider when reviewing an application under the [Bank Holding Company] Act." (Fed. Res. Bull. 2001: n.61 (Banamex), n.63 (EAB)).

To jump forward in the argument: if the FRB, Citigroup's and CitiFinancial's home country supervisor, will not consider CitiFinancial's worldwide compliance practices, who will? The FRB's approach can be contrasted to the stated jurisdiction of Sweden's Finansinspektionen, to which ICP Fair Finance Watch directed comments (regarding HSBC - Household) in 2003:

> Thank you for your letter concerning Predatory Lender Household International You mention in your letter that HSBC already runs the Household's business model in Sweden in HSBC Bank plc at Västra Trädgårdsgatan 17, Box 7615, 103 94 Stockholm.
>
> Financial Services Authority, (FSA), London, has notified Finansinspektionen that HSBC Bank plc - a firm authorised by the Financial Services Authority - has informed FSA to carry out activities in Sweden by its branch in Stockholm. The branch in Sweden is under supervision of the home country, FSA, with exemption for liquidity, which is supervised by Finansinspektionen. According to The Banking Business Act the branch is allowed to carry on the same business in the host country as is allowed in the home country. Finansinspektionen has no detailed knowledge about which type of lending, that is carried out in Sweden, why Finansinspektionen therefore cannot verify that the Household's business model is run by HSBC Bank plc branch in Stockholm. That means that if you have any points of view of the business run by the branch in Sweden, please contact the FSA in London, as the FSA has the homeland-supervision of that business.
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> --Margret Inger, "Response to Comments from Inner City Press / Fair Finance Watch," Stockholm: Finansinspektionen, July 24, 2003 (copy on file with ICP / FFW)).

It can also be contrasted to a response FFW recently received from Messrs. Franchetti and Robert-Nicoud of the Swiss bank regulator SFBC regarding Royal Bank of Scotland and its subsidiaries Coutts and Coutts Bank (Switzerland), which stated a refusal to consider comments that allegedly do not "directly concern[] Coutts Bank - a duly authorized and supervised Swiss Bank - and as such is not relevant to" [an RBS proposed acquisition in Switzerland].

This incongruity in approach -- deference verging on buck-passing to home country supervisors, then further buck-passing by home country supervisors like the FRB-- must be addressed by the BIS / BCBS, and by your agencies, including in

connection with Basel II. The explosion and export of controversial subprime consumer lending is not limited to Citigroup. For example, Wells Fargo, the fourth largest bank in the U.S. by assets, owns Puerto Rico-based Island Finance, which also has branches in Panama, Aruba, the U.S. Virgin Islands, and the Netherlands Antilles; in announcing the acquisition, CEO Dick Kovacevich said that it portended further "expansion into other Latin American markets." This was followed by the acquisition of Finvercon S.A. in Argentina, for example, and the opening of a branch of Island Finance at 2866 Third Avenue in the South Bronx. ICP/Fair Finance Watch's inquiries found that this branch charged 25% interest rates to all customers, without regard to credit history. The office was later closed, and its customers were instructed to travel to a Wells Fargo Financial office in adjacent Queens County to make their payments.

Wells Fargo is also engaged in controversial high-rate finance in Canada: Wells' "Trans Canada Credit charges 28.9 per cent interest," in the following ways:

> The first thing Labatte did receive appeared to be a credit card statement, showing a limit of $4,150, a billing date of Jan. 23 and a due date of Feb. 23. It stated no minimum payment was owed. Two more monthly statements followed, but Labatte claimed no statements arrived in April or May. He and his spouse both worked and failed to notice the six-month deferment period had expired.
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> By the time they started making inquiries, a representative of Trans Canada Credit informed them they'd missed the deadline for their "no-interest" offer and now owed approximately $600 in interest payments, dating back to the original date of purchase in November 2002. ("Know Your Deferred Contract; Buy Now / Pay Later Plans Can Become Costly," Hamilton Spectator, June 26, 2003, Pg. C2).

This is reminiscent of what is called predatory lending in the United States; Wells Fargo, however, had not included its Canadian or other non-U.S. subsidiaries in what few best practices and/or consumer compliance announcements it has made. While its 2000 SEC Form 10-K listed Wells Fargo Financial offices in Brazil, Hong Kong and Taiwan, neither in that SEC report nor elsewhere has Wells made public further information about these stealth, presumably high-rate consumer finance operations.

Note that ICP recently comments to the FRB and Wells' non-U.S. subprime lending, but this was not inquired into by the FRB staff letters to Wells in connection with its two most recent approved acquisition, nor was it adequately addressed in the

FRB's approval order[1] -- compare to the approach of, for example, the Swiss and Sweden regulators, set forth, and the loophole should be clear. This loophole should be closed, by means of your agencies' input on the new Capital Accords, and otherwise (in your agencies' consideration of applications for regulatory approval, and comments thereon).

The above-sketched trend is not limited to U.S.-based institutions. The largest U.K.-based bank, HSBC, on November 14, 2002 announced the acquisition of Household International for over $14 billion. A month previously, Household had reached a preliminary settlement of charges of predatory real estate lending and insurance practices with state attorneys general, for $484 million. HSBC seemed unconcerned: the Wall Street Journal of November 15, 2002, reported that Household "could also be rolled out to other countries, HSBC said. 'This is a business we could take to Japan,' HSBC's Sir John said. 'It's already an international business, but we think we could have opportunities in Brazil and Mexico. We haven't examined all the possibilities, but we think they could be extensive.'"

Over the next four months, and as will be shown relevant to the issues raised in this comment, ICP / FFW filed evidence documenting Household's practices, and HSBC's lack of proposed reforms, with regulatory agencies not only in Washington and a dozen U.S. state capitals, but also with regulators in the United Kingdom and elsewhere. The U.K. Financial Services Authority said it defers on such matters to U.S. regulators, primarily the Federal Reserve Board. But the HSBC and Household structured their transaction so that no U.S. Fed approval would be needed -- even going so far as to sell off one of Household's banks on a "break-even basis" so that no application to the Fed would be required. (Gary Silverman, "Household Acts to Thwart Block on Bid: HSBC Acquisition Threatened," Financial Times, November 20, 2002, Pg. 24). The OTS facilitated Household's "de-registration" as a thrift holding company; the FDIC facilitated the acquisition of Household's Orchard Bank thrift, to a small bank named Panhandle -- all to avoid holding company-level scrutiny of a proposal to acquire a scandal-plagued subprime lender. These actions bode badly for the type of consolidated and

[1] As to GE, mentioned above, the other U.S. holding company-level supervisor the OTS has neglected to consider its subprime consumer lending anywhere, at least behind its

comprehensive supervision widely called for after BCCI and otherwise. The loophole should be closed, as part of this process and beyond it.

The lack of systemic regulation of this high-rate lending is problematic, including as relates to Basel II. Canada's OSFI, for example, has refused to consider lending disparities documented at the largest banking group under its supervision, the Royal Bank of Canada; the U.K. FSA has sought to defer to the FRB as regarding Royal Bank of Scotland, despite the FRB's statements, reiterated in a July 2003 order, that the FRB will consider a bank holding company's lending outside the United States only if the actions are illegal in the country they are taken in, or, in the Fed's view, impact on the safety and soundness of the institution.

This can, of course, happen: take, for example, the impact on Deutsche Bank of its shameful past during the Holocaust, and the resultant effect on moral as well as financial capital. More recently, legal and financial claims concerning activities in South Africa are pending against a number of the banks that would be affected by Basel II; we also note, for example, the United Nations 2001 report naming Citigroup, *inter alia*, as being an enabler in the trade of conflict diamonds from the Democratic Republic of Congo, and earlier reports that Citibank (as well as Dresdner Bank and Banque Nationale de Paris) continued banking business with the deposed and discredited Interahamwe-tied government of Rwanda in 1994 (*see, e.g.*, Le Soir, January 27, 1997; the Human Rights Enforcement project, *humanrightsenforcement.org*, is working on this issue -- it was raised to the OCC, in opposition (with other issues) to an application by a Citigroup national bank, and no action or inquiry whatsoever was undertaken by the OCC, in seeming contravention of the OCC's duties as an "organ of society" under various human rights treaties to which the U.S. is a party. These are examples of types of operations / reputational risk, even beyond the subprime lending issues on which this comment has focused, of which Basel II must take account. It is imperative that your agenices conduct further outreach (including beyond banks and their regulators),[2] that harm to consumers

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thrift's small assessment area in Ohio, much less overseas.

[2] We noted that the Federal Reserve near-entirely excluded consumers' and civil society organizations from its Basel II-related outreach. Meetings were held, but only with bankers (www.federalreserve.gov/generalinfo/basel2/docs2003/attendee.htm). The World

(which can and does reverberate in harm to banks' reputations and capital) be taken account of in your agencies actions with respect to Basel II, and otherwise. Thank you for your attention.

Very Truly Yours,

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Bank, the IMF, and even the World Trade Organization, increasingly at least reach out to civil society organizations. This has not been the case with the Federal Reserve, nor the OTS, FDIC nor OCC, each of which has, for example, denied detailed hearing requests in recent months. As stated above, ICP contends that in some cases these hearing denials and refusals to act violate your agencies' duties as an "organ of society" under various human rights treaties to which the U.S. is a party. ICP and FFW will be following up on this in coming months.